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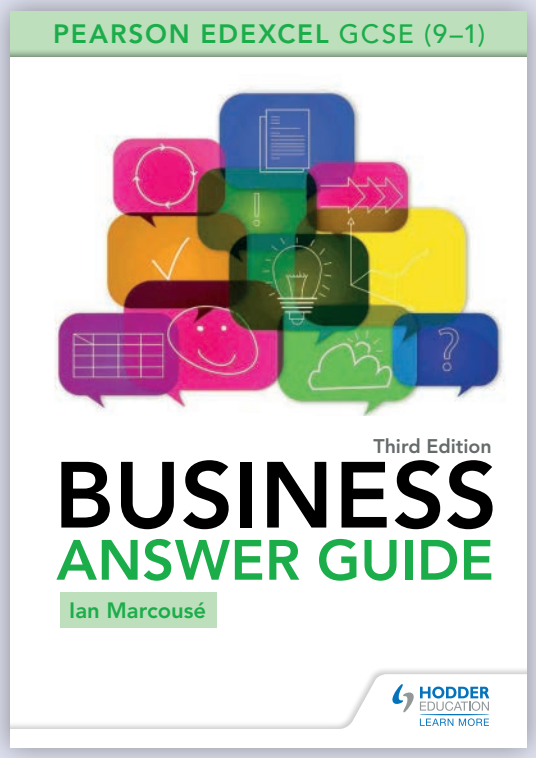

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Introduction

Acknowledgements

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Personally, the most important input came from my 3-year-old grandson James, whose question: 'Why do shops die?' deserves a 12-mark exam question of its own. For him, my wife Maureen and the rest of my family, writing books means time locked away – so my love, thanks and apologies to them all.

Dedication

This book is dedicated to Marcousés: Carly, James, Lily, Owen, Scarlett, Skye and Tillie

Using this book

There are five main ways to use this book. The very best students might use all of them, but using any one of the five will help towards exam success.

Read it. The chapters are written to be read. They're not too long, and are packed with real-life examples to help make the theory more understandable. A classroom lesson plus a read through the relevant chapter will put you in control. If you can find the time, test yourself on the 'End of chapter exercises'.

Look it up. The index at the back of the book helps you find the precise topic your homework is about – or the topic you've been told is coming up in tomorrow's test. That means you only need to read what you need. Make sure to check whether there are relevant definitions given in the 'Revision essentials' boxes.

Build on it. At the end of each chapter are exam-style 'Practice questions'. Each question gives you some text about a real business, then exam-style questions. Each one is a mini-mock exam. Have a go and then ask your teacher for a copy of the author's answers (available in the Answer Guide). This will be a very useful way of preparing for the exams.

Revise it. At the end of each section of the book are multiple-choice questions that enable you to test yourself quite quickly (and without much writing). These sections of the book mirror the specification and are therefore helpful for exam preparation. Your teachers have the answers in their Answer Guide.

Key revision terms. Towards the end of the book is a very full Glossary. It covers every term set out in the Specification – and is therefore crucial to your exam revision.

Teachers will be pleased to know that an Answer Guide is available for this book: Pearson Edexcel GCSE (9-1) Business Answer Guide Third edition, ISBN 978-1398356351.

Theme 1

Investigating small business

1 The dynamic nature of business

Business **enterprise** is about starting something of your own. It would probably be a business, but it might also be a charity or a sports club. The key is that *you* want to do it, and that it proves to be a success. However, changes in technology, in fashion and in the economy mean that success can never be taken for granted. These changes represent the **dynamic nature of business**, and are illustrated by the following story.

Evan Spiegel first presented his idea for Snapchat to his classmates in 2011

In 2011, Evan Spiegel made a presentation to his university class about an app idea called Picaboo. He demonstrated photos being taken and sent by phone, and then disappearing. His classmates weren't impressed. Convinced he was on to something, Spiegel kept working on the idea with two friends. A couple of months later, a renamed Snapchat got a low-key launch. Student take-up in California enabled the new business to raise $13.5 million in **venture capital** in early 2013. Such was Snapchat's growth that, by late 2013, Facebook offered to buy the business for $3 billion. By 2016, Snapchat had overtaken Twitter's user numbers. Then the Covid-19 pandemic propelled its user figures to 280 million by early 2021 (see Figure 1.1) – and boosted Spiegel's wealth to $11.6 billion.

The dynamic nature of business arises because of changing customer tastes and needs, which are driven by changes in technology and in other factors outside the business' control. The unexpected 'out' vote in the 2016 European referendum was a case in point. Suddenly companies had to rethink their plans in the light of a new economic reality, that Britain was leaving the European Union. Successful businesses are the ones that can adapt quickly to new circumstances.

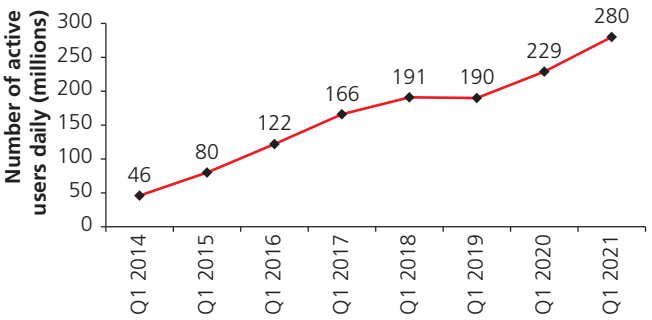

Figure 1.1 Snapchat: daily active users globally

> Chase the vision, not the money; the money will end up following you.
>
> *Tony Hsieh, Zappos CEO*

When starting a new business, all the challenges speed up. Decisions that a big company has months to think about must be decided immediately. Should the new burger bar buy one milkshake machine or

two? Quickly, decide! Should it sign up to Just Eat or create its own e-commerce website and app? Decide! In business, virtually every decision costs money and, because most start-up businesses are short of cash, the personal pressure involved in each decision gets ever-greater.

The three main questions to ask about start-ups are:

1. Why?
2. Who?
3. How?

Why?

The main motive for starting up something new is desire. People want satisfaction from a sense of achievement. If they could get it from their normal workplace, they might not take the risk of starting on their own.

The next most important motivator is the wish to be your own boss. Independent decision making allows the individual to do things the way that they think is best. Most jobs involve a degree of compromise. When you are running something for yourself you may not be able to afford the best, but at least you know that you will get the best you can afford. So, the chef who hates working in a cramped kitchen with second-rate ingredients may long to be in a position to make all the decisions.

Then, of course, there is money. A person may start a burger bar because of their conviction that they will make a fortune. Such a person may dream of retiring early, with a beachfront house and a huge fridge packed with beer. The typical business to go for would be a franchise, in which the individual buys the rights to open a local branch of a business that already exists (and makes good profits). The Subway sandwich chain works in this way.

> The common question that gets asked in business is, *why*? That's a good question, but an equally valid question is, *why not*?
>
> *Jeff Bezos, founder of Amazon*

Who?

A successful start-up requires a huge list of qualities and skills, especially if starting up on your own. Among these are:

- personal qualities: determination, resilience (can bounce back from setbacks), enthusiasm, hard-working, decisive, willing to take risks
- skills: can listen as well as speak, can plan and organise, can persuade, can manage others
- resources: can find help when needed (finance or advice), may have exceptional knowledge of a special topic (for example, building a website).

Of course, few **entrepreneurs** (business risk-takers) have *all* these qualities, but without quite a number of them it will be hard to succeed.

How?

The most common way to start a new enterprise is to trial a business idea while still working, often from your own home. It is tried out in a limited way before committing too much money and time.

Duncan Goose, however, started bottled water brand One as a social enterprise by giving up his regular job. The water is bottled in Wales and sold throughout Britain, with the profits going to the One Foundation, a UK-registered charity funding water projects in Africa. It took him six months, without pay, to get the enterprise going.

When people need to raise capital to help them start a business, they write a business plan. This sets out the aims, the strategy, the financial forecasts and financial requirements. If carried out professionally, a good business plan greatly increases the chances of getting funding. Crucial to a good business plan is a sensible sales forecast based on independent market research.

> Ideas are easy. Implementation is hard.
>
> *Guy Kawasaki, marketing specialist and venture capitalist*

one
switch water change lives
SWITCH WATER
CHANGE LIVES
One Water is a life-changing brand.
So far, we've helped The One Foundation raise over £20 million changing the lives of over 3.6 million people.
Choose One Water and join the fight to ensure everyone has access to clean, safe water. Forever.
onewater.org.uk
@onewateruk
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One works to provide clean water in Africa

Talking point

Which of the 'who?' qualities are strengths of yours? Which are weaknesses?

Drawing the right conclusions

Business is exciting because of its dynamic nature. A business may seem to be unstoppable one year. Every decision works out well. The next year, nothing is quite the same. A best-selling business book called *In Search of Excellence* was written to explain why 43 companies were excellent. Famously, by the time the book was published even some of those companies were struggling. The dynamic nature of business is such that today's star can be tomorrow's fall guy.

If there is one general point that can be made about business, it is that sustained business success comes to companies that keep talking to customers and keep adjusting to their new needs and wants.

> A man is a success if he gets up in the morning and gets to bed at night, and in between he does what he wants to do.
>
> *Bob Dylan, musician*

Revision essentials

Dynamic nature of business: the idea that business is ever-changing because external factors, such as technology, are always changing.

Enterprise: the personal characteristics of questioning and initiative that can be shown by an employee or an entrepreneur.

Entrepreneurs: businesspeople who see opportunities and are willing to take risks in making them happen.

Venture capital: capital provided by an investor willing to take a risk in return for a share in any later profits; the venture capital provider will take a share stake in the business.

End of chapter exercises

1 Outline two dynamic forces currently putting pressure on companies in the market for:

(a) potato crisps

(b) takeaway pizza.

2 Using the information in Figure 1.1 on page 2, calculate the percentage increase in active users between the first quarter of 2015 and the first quarter of 2021.

3 Why might a young entrepreneur prefer to start a franchise, such as Subway, than a wholly independent business?

4 Without looking back at the text, briefly write down what you understand by the 'why', 'who' and 'how' of starting a business.

5 Have you recently seen any new business that you admire opening up locally or online? Briefly outline what it is and what you admire about it.

6 Read the following extract and answer questions (a) and (b).

Although women make up 50 per cent of the working population, only 14 per cent of executive directors of big businesses are women. About 15 per cent of the UK population is non-white but only 1.5 per cent of executive directors are non-white. This apparent ceiling on career prospects may explain the huge amount of interest in business start-up among women and non-white people. Unfortunately, even then discrimination may apply. A recent survey suggested that banks charge businesswomen a one per cent higher interest rate than businessmen.

(a) Why might the figures 'explain the huge amount of interest in business start-up among women and non-white people'?

(b) Outline two possible reasons why a bank might charge businesswomen a higher rate of interest than men.

Practice questions

Kitty Café

A safe home for cats

The first Kitty Café opened in Nottingham in March 2015. Abandoned cats and kittens are welcomed – as are paying customers wanting paninis, tea and cake – with cats everywhere. For cat lovers it's both a treat to be among lots of cats and a good feeling to be contributing towards looking after stray cats. The cafe also acts as a cat showroom – the hope being that visitors will fall in love with a cat and then adopt it. Co-owner Kate Charles-Richards says: 'We are operating as a cat rescue and our number one concern is the welfare of cats. We want to find them a permanent home.'

When it first opened, people talked of concerns about cat hairs in the food – but the cafe is designed to keep the kitchen enclosed – with no chance of catamination. The success of the Kitty Café was shown by an announced expansion to open a second cafe in a prime city site in Leeds. The site benefited from a £500,000 refit, and architects were commissioned to design a cat-friendly environment with full air conditioning, large windows and a luxury 'cat snug' – a human-free area for the felines to retreat to and relax in.

Kate said at the time: 'We are getting more and more excited about Leeds. There is still a lot of work to do. As we have massive expansion plans in the UK, Leeds is going to be our showcase,' said Kate, who is bringing two duty managers from her Nottingham cafe to run the new site. 'No expense is being spared on our kitties and the customer experience. We have a team of companies working with us to get every tiny detail correct and this will mean the third and fourth Kitty Cafés will follow quickly.' That proved true: by 2021 there were further sites in Birmingham and Leicester.

Total: 20 marks

1 Outline one possible reason why Kate saw an opportunity for this business idea. (2)

2 Outline one benefit to the business if it bases its next cafe opening on a carefully-written business plan. (2)

3 State one reason why customers might be concerned about the cleanliness of the food. (1)

4 Analyse the skills Kate may have needed to make a success of this particular business start-up. (6)

5 Expanding the Kitty Café rapidly can bring financial and non-financial rewards to Kate. Justify which one of these two rewards is likely to be the more important to her. (9)

2 Why new business ideas come about

In early 2021 ice cream brand Northern Bloc received a £1.5 million investment to start production of vegan ice cream. Using rice milk instead of dairy, the company tapped into interest in plant-based foods with flavours such as salted peanut and chocolate. The outside investor enabled the business to accept new listings in Waitrose, the Co-op and Morrisons. This is the essence of why new business ideas come about. Consumer tastes change constantly, creating new opportunities for business success. Some are filled by existing big companies with big pockets, but surprisingly many are filled by bright new businesses with new ideas.

New business ideas come about because there are:

- changes in what consumers want
- products and services becoming obsolete
- changes in **technology**.

> Business opportunities are like buses. There's always another one coming.
>
> *Richard Branson, founder, Virgin Group*

Changes in what consumers want

We may all *want* a brand-new BMW, but most of us will not be able to afford one. For changes in consumer taste to matter, they must be backed by the ability to pay. This is known as **demand**.

There are several possible reasons why consumers turn to a new idea such as vegan ice cream:

- There may be changes in social attitudes, with people worrying more than before about issues such as animal welfare and global warming.
- There may be technical breakthroughs, allowing a product to be made to a higher quality standard than before.
- Improved standards of living may allow customers to buy more expensive goods than they could afford previously.

Price is another important factor. The price of a product or service is a key influence on the level of demand. If a company charged too low a price, customers may lose confidence and go elsewhere: a wedding dress for £99.99 might not win hearts and minds.

In the vast majority of cases though, higher prices push demand down. A price increase for Pepsi would cut demand, especially if it made it more expensive than Coca-Cola. Price increases may push products out of people's price range and encourage customers to look for cheaper substitutes.

Talking point

Can you think of any social changes happening at the moment that might lead to new business opportunities? A new product or perhaps a new service?

> An industry begins with customer needs, not with a patent, a raw material or a selling skill.
>
> *Theodore Levitt, economist and business thinker*

Products and services becoming obsolete

A product or service is **obsolete** if no one wants it any longer. There is no longer great demand for chimney sweeps, as few people have an open fire. Similarly, there's hardly any demand for traditional butcher's shops as people eat less meat and, in any case, buy it in supermarkets. As people change their behaviour, some businesses stop being relevant. Among London's black cab drivers, there's real concern that sat-nav systems and Uber may make them obsolete.

Businesses therefore need to think ahead to how customer habits are changing and try to keep one step ahead. Despite the huge success of Sony's PS4 and the Xbox One, Nintendo managed to find a new way into the games market with its innovative Switch. Even after Sony had introduced the PS5, the Switch was outselling Sony two to one in mid-2021.

Figure 2.1 shows the success of the Sony PS4 until Nintendo launched its Switch in 2017. Fortunately for Sony, it believes its PS5 will outsell the PS4 in the long term. Its sales in 2020 and 2021 were held back by production shortfalls.

Talking point

What would you expect to be the sales of Switch in 2022 and 2023, based on Figure 2.1?

If changing customer tastes keep making products and services obsolete, it is critical to keep coming up with new, bright business ideas. For chocolate companies such as Ferrero, it means keeping up with changing tastes and fashions; for companies such as Dyson and Apple, the key is to keep up with changes in technology.

> Obsolescence never meant the end of anything, it's just the beginning.
>
> *Marshall McLuhan, writer*

Changes in technology

Until mobile phone networks operated at the bandwidth known as 3G, smartphones could hardly function. Vodafone launched 3G in the UK in late 2004, but it was only over the following two years that it became widespread. Apple's iPhone arrived just on cue in early 2007. Without 3G technology, there would be no iPhone as we know it. New technology is a classic cause of new business ideas.

Vodafone was the first network to launch 3G

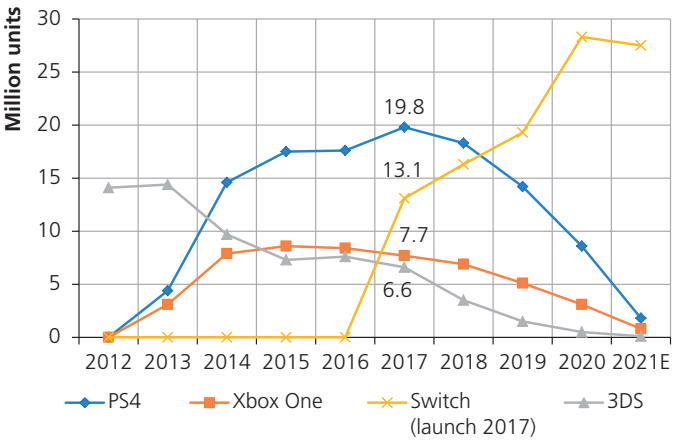


Figure 2.1 Global sales of selected games consoles (excluding 2020 launches of PS5 and Xbox XS) (Source: VG Chartz)

Table 2.1 New technologies and their potential uses

New technology	New products/uses
GPS (global positioning system)	Sat nav Pet-monitoring collar Self-driving cars
3D printing	One-off prototypes to test new product ideas Tailor-made artificial limbs Made-to-measure printed shoes
RFID (radio-frequency identification)	Keeping tabs on stock in-store Race timing (how marathon runners are monitored) Libraries (more efficient than barcode scanning)

Changes in technology have two main impacts: they create opportunities for new things, and increase the likelihood that old things will become obsolete. Combined, this means problems for slow-moving companies and exciting opportunities for smaller, newer, speedier ones. The key for new small firms is to keep fully on top of the new technology, and be willing to take risks trying out new ideas.

> Once a new technology rolls over you, if you're not part of the steamroller, you're part of the road.
>
> *Stewart Brand, business author*

Drawing the right conclusions

Despite the start of the pandemic in 2020, there were more than 650,000 business start-ups in the UK. Overwhelmingly, the start-ups occur because individual entrepreneurs see new opportunities due to changes in customer taste or the arrival of new technology. The individuals have the initiative and the financial backing to turn their business dream into reality. Their chances of success will depend on:

- whether their idea is as original and as relevant as they believe
- whether their competitors prove tougher and cleverer than expected
- whether their customers become customers who stay; customer loyalty is crucial.

Revision essentials

Demand: the number of units that customers want – and can afford – to buy.

Obsolete: a product or service with sales that have declined or come to an end as customers find something new.

Technology: hardware and software that can help people be more productive.

End of chapter exercises

1 What changes might come about over the next three years in the markets for:
   (a) chocolate
   (b) mobile phones.

2 Look at Table 2.1. Outline two possible reasons why 3D printing has not yet been successful in the UK.

3 Outline two factors that might cause motorbikes to become obsolete.

4 Using the information in Figure 2.1 on page 8, calculate Switch's 2017 share of the global market for games consoles.

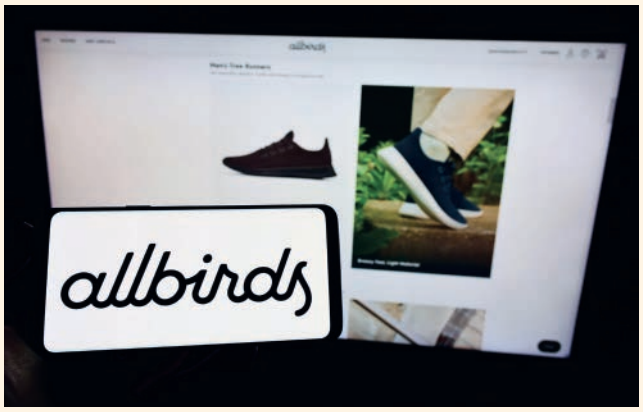
5 Look at the quote by Marshall McLuhan on page 8. What do you think it means?

6 Figure 2.1 shows that sales of the XBox One had been sliding even before the 2017 launch of Nintendo's Switch. By 2020 the XBox was becoming obsolete. Discuss the factors that may have led to the XBox One becoming obsolete by 2020.

7 In late 2020 XBox launched its new XS console. What factors may prove the most important in determining whether the new XS is a success?

Practice questions

Allbirds' billion dollar trainers



Allbirds trainers

Worth only a few thousand dollars when it started up in 2015, Allbirds was valued at over $2000 million by August 2020. Wearers/fans include Barack and Michelle Obama and Mila Kunis. Founded by a former professional footballer and an industrial engineer, Allbirds has two claims to fame: ethical manufacture using recyclable materials such as wool, and the claim to be the world's most comfortable shoes.

The business took off after obtaining a patent (which gives an inventor 20 years until a rival can legally copy their manufacturing technique) on its wool-based shoes and managing to raise $200,000 of finance via the crowdfunding site Kickstarter.

A recent report says that over 80 per cent of consumers aged 26–34 consider companies' social and environmental practices to be extremely important. These people are likely to be drawn to Allbirds, as its trainers are made from materials like merino wool, recycled PET bottles, recycled cardboard and sugarcane.

'The footwear industry often overlooks natural materials in favor of cheaper, synthetic alternatives. We think it's time to change that', says the brand on its website.

The business started out as an online-only business, but now has nearly 20 shops. Its first London store opened in 2019, in Covent Garden. At the same time, Allbirds opened its first store in China.

Despite Covid-19, in 2020 things went brilliantly for the business. It opened more stores in China (the world's biggest market for trainers and where $100 is an acceptable price for a US-made product) and enjoyed an online sales boom. It even forced Adidas to develop its own trainers made from natural materials. Such is the trend towards Allbirds trainers that an artist in Ghana has put on sale hand-painted shoes that have a significant price premium.

Total: 20 marks

1 Outline how hand-painting might add value to Allbirds shoes. (2)

2 Explain how the success of a business can be based on understanding changes in what customers want. (3)

3 Analyse the possible effect on Allbirds' two founders of the rewards they will get from the company's success. (6)

4 The new business idea behind Allbirds could have come from either of these two sources:

- Option 1: Original ideas
- Option 2: Adapting existing products/services/ideas

Justify which **one** of these options is a better explanation of Allbirds' start-up. (9)

3 How new business ideas come about

Creative thinking stems from asking questions. Three-year-olds can drive their parents crazy by constantly asking 'why': 'why does granny smell?', 'why are raspberries red?', and so on. In fact, just such a question about raspberries made the producer of Slush Puppie drinks decide to make the raspberry flavour a blue colour. The red (strawberry) and blue (raspberry) made a more eye-catching display.

The ability to ask 'why' is at the root of creativity, innovation and how business ideas come about.

> Disneyland will never be completed, as long as there is imagination left in the world.
>
> *Walt Disney (1901–66)*

Why not?

It is also vital to ask 'why not?'. The three-year-old is trying to find out the way the world is. Creative thinkers also ask 'why shouldn't the world be different?'. In 1933, Percy Shaw became the inventor of one of the world's most widely used ideas. Driving home in dense fog he nearly drove off the road and crashed, but was saved by the flashing eye of a cat sitting on a fence. Two years later he patented the cat's eye, an invention that made him a fortune. Brilliantly, he made a reflector with a rubberised top that would give when cars ran over it; the action of pushing down the rubber top wipes the reflector clean – just like a cat's eye blinking.

Cat's eye reflectors made their inventor a fortune

Many 'why not?' questions are much less significant than Percy Shaw's. For example, why not have a strawberry-flavour Calippo ice lolly? Such an obvious idea might be hugely significant if it proves a commercial success.

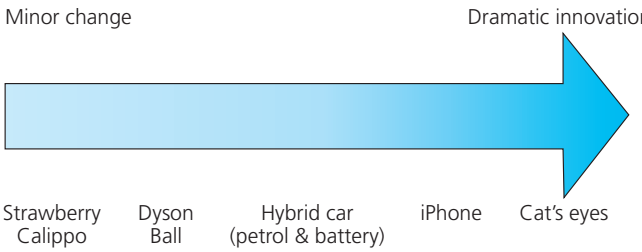


Figure 3.1 A new product will sit at some point along a scale ranging from minor change to dramatic innovation

Original ideas

Most of us have lots of creative thoughts. We look in an ice cream cabinet and wish there were a mint choc ice or a mango lolly. The problem is that we may not tell anybody about these thoughts, or – worse – we may try to tell someone but find that nobody listens. It follows that creativity may only have meaning if it is backed up by effective communication. Percy Shaw had his idea and developed it himself. Most of us have neither the money nor the ability to achieve this.

Well-run businesses encourage the sharing of **original ideas**. Ordering a tailor-made kitchen from German manufacturers used to involve a three-month wait before delivery. Now staff at a leading German kitchen manufacturer have found new ways to use their computer-aided design (CAD) system to cut delivery times to three weeks.

For some businesses, original ideas are the basis of the operation. Rockstar North employs over 600 people in Edinburgh, creating world-leading computer games. Their biggest success by far is the Grand Theft Auto franchise. The game first came out in 1997 and the sixth edition is expected in 2022. As of May 2021, the whole series had sold 345 million units, making it one of the all-time best-selling games series.

> The man who has no imagination has no wings.
>
> *Muhammad Ali, greatest ever boxer*

New ideas and competitive advantage

Competitive advantage is a term given to any factors that help a business to succeed when competing against direct rivals. For airline Ryanair that advantage comes from low-cost operations that allow it to charge low prices. For many other businesses, original ideas are the key:

- Klein Vision Aircar – in November 2020 Slovakian company Klein Vision announced that its Aircar will be ready for sale by 2022. On the road it looks like a sleek, low-slung sports car, but it also flies. Boss Professor Klein has been working on the project since 1989 and has completed more than 50 flights. Apparently it takes just 3 minutes to convert the car to an aircraft. The purchase price has not yet been announced.
- Galaxy vegan chocolate – this was launched by Mars in 2020 featuring flavours such as Smooth Orange and Caramel & Sea Salt. Sales of ordinary Galaxy fell by 14 per cent in 2020; no wonder they needed to come up with something new.

The Klein Vision aircar

> The creativity that emerges from the company comes from the many ideas of the people who are here.
>
> *John Rollwagen, chief executive*

Adapting existing products and services

The overwhelming majority of new product launches are derived from an existing product success. This is as true for James Bond films as it is for chocolate bars. **Adapting existing products** or services is an attractive business proposition for the following reasons:

- It usually requires less research and development, and other investment, to develop a new product variation than a completely new product. It is also likely that you have already developed the production machinery and methods that can now be adapted to Product B. Overall, adapting is a much cheaper option, and that makes it possible to enjoy high profit margins.
- It is easy to underestimate how hard it is to find a new product that people love (80 per cent of new products fail). So, if you have a success, it makes sense to milk it. Your chances of making money from a new *Superman* film are greater than from creating a brand new film.

- Launching an adapted product can successfully protect your first/main product. If you have created Cadbury Dairy Milk, why leave yourself vulnerable to attack from rivals by leaving open the opportunity to do a bubbly version or one with nuts and raisins.

Here are two examples of successful adapted products:

- Monster Energy Ultra launched a zero calorie but vibrant brand into the £750 million market for energy drinks. By offering a no-calorie drink tasting more like a soft drink than an energy drink, brand owners Coca-Cola wanted to bring more women into the energy sector.
- In 2020 Warburtons announced the launch of a new range of full-sized bagels. This was a follow-up to its earlier launch of Thin Bagels, which were generating sales of £20.5m a year.

Talking point

Can you come up with a new chocolate bar that can match the advertising slogan once used by Cadbury's Crunchie for 'that Friday feeling'?

Drawing the right conclusions

For companies such as Heinz, with stable, big sellers like ketchup and baked beans, new ideas are a luxury. If they work, that's wonderful, but if they don't they'll still go on selling more than £500 million in the UK. For other businesses, new ideas are essential. The smartphone market is unforgiving. The combination of the successful launch of the iPhone 12 and the condemnation of Donald Trump saw sales of Huawei phones halve during 2020.

The ability to keep coming up with ideas tends to depend on a number of factors:

- Staff who really care and are engaged in the jobs they do: Google, yes; Sports Direct, no.
- The amount of cash the company devotes to research and development, market research and investing in new technology. This may require a business to limit its dividend payouts to shareholders to make sure there's enough capital for financing the future.
- The diversity of the recruitment approach: if all managers are ageing men, it may be hard to spot the new possibilities in dynamic, younger markets, such as mobile gaming.

Revision essentials

Adapting existing products: finding new products based on the original one, such as Wall's White Chocolate Magnum.

Competitive advantage: features of a product or service that make it stronger in the marketplace than its competitors.

Original ideas: ideas that have not been done before.

End of chapter exercises

1 Outline two benefits that a business can gain from asking the question 'why'.

2 What might be a correct business response to the following questions:

(a) Why are organic foods so expensive?

(b) Why does Lidl keep growing in the UK grocery market?

(c) In what way might the launch of Warburtons' full-size bagels damage the company's sales?

3 Suggest two ways in which managers could encourage staff to share their own ideas about new products.

4 Read the following extract and answer questions (a) and (b).

Encouraging and using ideas 'from the floor' can have dramatic results, as at BMW's Mini factory at Cowley, Oxford. The BMW group announced that suggestions from staff at Cowley have saved the company £10.5 million in two years. Of the 14,333 suggestions staff put forward, three quarters were put into action. They ranged from cutting unnecessary use of paper to more complex engineering solutions.

(a) What is the most likely explanation for the high number of suggestions from the Cowley staff? Explain your reasoning.

(b) Discuss whether the staff should get a financial reward for the suggestions that are put into action.

5 Read the following extract and answer questions (a) and (b).

Lily was so short of money she asked her grandad if she could weed his garden. She soon realised she couldn't tell whether she was pulling up flowers or weeds. Grandad said he always had the same problem. They needed an app that could tell weeds from flowers and give a quick bird whistle for a flower and loud bark for a weed. She saw immediately it could be her Computer Science GCSE coursework as well as a possible business winner. A quick Google search gave an estimate of 27 million gardeners in the UK. A vast market.

(a) Examine one reason why Lily's business idea might be a good one.

(b) Discuss what might give Lily's app a sustained competitive advantage.

Practice questions

Me & the Bees

Mikaila and the Bees

In 2009, aged 4, Mikaila Ulmer set up a table in front of the family home, and began selling lemonade based on a 1940s recipe from her great-grandmother. The recipe contains honey, and around the same time Mikaila got stung by two bees in two weeks.

To help her overcome her fear of bees, her parents explained their importance in pollination and therefore the food chain. This encouraged Mikaila to give some of the money she raised from the sale of the lemonade to organisations that protect honey bees. Soon the business was supplying lemonade to a local pizza shop, with 10 per cent of profits donated to bee conservation groups. And from that idea came the brand name: 'Me & the Bees'.

Big breakthroughs came in 2015, when Whole Foods Market agreed to stock the brand. And then in 2016, Mikaila (then 11) won a $60,000 investment in the US version of *Dragons' Den*.

Her profile kept jumping ahead as former President Barack Obama invited her to meet. From the publicity surrounding this came an $800,000 investment from a group of current and former American football players. With this extra capital she developed a fuller range of four flavours (Lemonade with Prickly Pear, Mint, Ginger and Iced Tea) – all are doing well, the company says.

Geoffrey Soares, owner of Summit Beverage Group, which started bottling for Me & the Bees Lemonade last year, says that Mikaila is a very strong brand ambassador: 'You can have a great product, but if you don't have a great story, how are you going to get noticed? This is a tough, $200 billion industry. Without Mikaila, I would question how they would break through. She is very important, but at the same time everyone needs help – they are a good family, and they are committed to building something.'

Total: 20 marks

1 Outline how this business idea came about. (2)

2 Analyse the ways in which Me & the Bees has been able to stand out in this 'tough, $200 billion industry'. (6)

3 So far, Mikaila's business has been very successful. Evaluate whether it is likely to continue being successful over the next few years. You should use the information provided as well as your knowledge of business. (12)

4 Risk and reward

Risk is about chance. What is the chance that a particular outcome will occur? Large firms know that, over the years, only one in five new products is a success. So, the chance of failure is four out of five. Does that mean firms should never launch new products? No. They must either:

- make enough profit from existing products to fund five new product launches for every one success
- make sure that the one success is big enough to make up for the failures.

> The biggest risk is not taking any risk.
> *Mark Zuckerberg, founder of Facebook*

Mark Zuckerberg invented Facebook

Risks can yield rewards

In 1984, teenagers Richard and David Darling moved on from playing computer games to writing them. They produced the games for fun, but then tried advertising them in a popular computer weekly. A £70 advertisement brought in £7000 worth of orders. In 1986, they formed a company, Codemasters Ltd. It went on to produce some of the longest-lasting games software brands, such as Colin McRae Rally and LMA Manager. By summer 2015 it was number two in the UK games chart with Dirt Rally and had launched a hugely successful F1 game. In February 2021, the US giant EA Sports bought Codemasters for $1.2 billion. Risking £70 on an advertisement has resulted in fabulous wealth and an amazing achievement.

Table 4.1 What are the main risks?

At the start	In the early days	When growth is rapid
Identifying a market gap big enough to be profitable	Making sure your initial customers come back for more	'Overtrading' – sales growing faster than you can cope with financially
Raising (more than) enough capital	Running out of cash during the off-season	Struggling to manage rapid rises in staff, especially middle management
Getting the right people working in the right way	Running out of energy and self-belief when times are tough	The entrepreneur owner may struggle to be a good manager
Building a base of initial customers	Coping with competition when it arrives	The boss and staff may become complacent, so the rise leads to the fall

Risk

Business failure

Half of UK business start-ups fail within five years. That means they have closed their doors. Some others survive but without making enough profit to feel happy. If a teacher hands in his or her notice to start their own business, not only are they giving up a steady salary and a high degree of security, they are also giving up a guaranteed pension in years to come.

Business failure may not only use up all the family's savings, but may also put huge strains on the family itself. Divorce can be a consequence of a business failure. This is why new businesses only tend to be started by people with huge self-confidence and, preferably, deep pockets.

Financial loss

If a limited company gets into financial trouble, the owner is protected personally from business losses. If the company has £200,000 of debts that it cannot repay, the problem stays with those owed the money. The company owner does not have to pay. When companies fail, the people who suffer most are the suppliers and the workers.

But most UK businesses are sole traders or partnerships, and therefore have unlimited liability (see Figure 4.1). This means that the company founder/boss is liable personally for any and all of the business debts: £100,000 here for an unpaid bill, £150,000 there to an unhappy customer who has successfully sued.

Starting your own business can be a path to huge riches, but it can also be a path to a personal financial disaster.

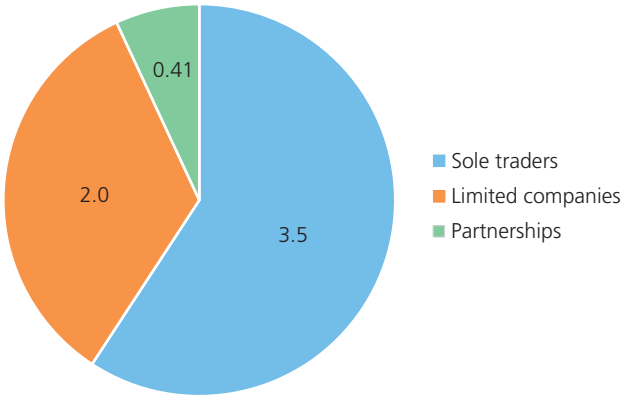


Figure 4.1 Business organisations in the UK (figures in millions)

Table 4.2 The way it is: risky business

The business start-up	The business idea	The risks
PledgeMusic offered music artists a special online platform for crowdfunding concerts and pre-ordering CD or vinyl records. Artists signed up, then PledgeMusic collapsed	Instead of getting a record company to promote your career, take control by doing it yourself on PledgeMusic. The artist decides on venues and prices, then promotes them her/himself on the online platform	For the artists, it proved to be that the cash that came in to PledgeMusic was passed on slowly – or not at all – by the site. As the business developed a poor reputation, people stopped using it and the business opportunity died
DW Sports opened in 2009, backed by the wealth of entrepreneur Dave Whelan. Having built annual sales above £10 million, it closed in August 2020 after several years of operating losses	The idea had been to offer cheaper access to fitness than the huge monthly subscriptions at centres such as David Lloyd and Virgin. DW Sports also hoped to sell sportswear as well as access to the up-to-date gyms	DW Sports found itself a piggy-in-the-middle. New businesses such as The Gym Group were offering cheap monthly memberships, undercutting DW Sports. With David Lloyd above and The Gym Group below, DW was squeezed out
Sunderland-based Bespoken Interiors Ltd closed in 2020 after several years of struggle	It offered interior design services to companies (for head office reception areas, for example) and to wealthy homeowners	As competition grew and the town of Sunderland was struggling, the level of business dwindled, as did profitability

Lack of security

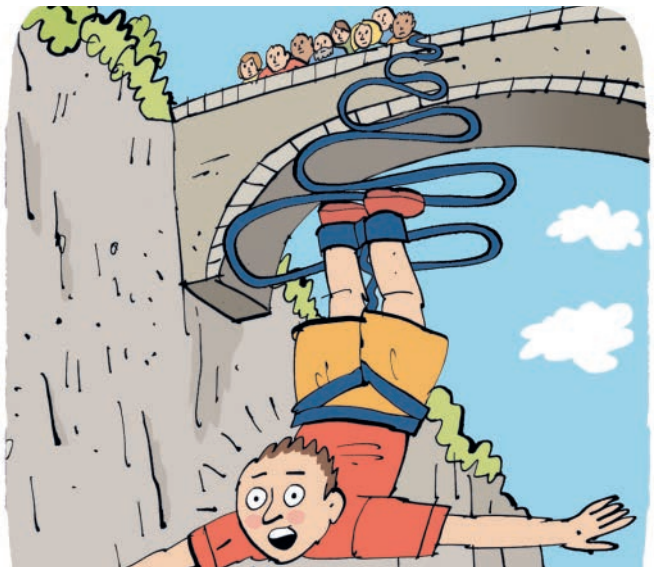
Adults often have responsibilities (children, a mortgage, credit card debts) that force them to look for a secure, stable income. Working for the council or for Marks & Spencer means a regular salary. Even entrepreneurs who have gone on to make fortunes have had periods when they weren't sure of the next pay packet. Starting a business is full of factors that are outside your control, such as an ice cream parlour hit by a cold, wet summer. A regular pay packet may be very difficult to achieve. The **lack of financial security** is a major risk factor when starting a business.

> He who is not courageous enough to take risks will accomplish nothing in life.
>
> *Muhammad Ali, boxer*

Reward

Business success

Excitement comes from taking risks (that is, the risks generate the rewards). It is the difference between riding a bike on the flat and riding it down a steep hill; or watching Brazil play football compared with watching Austria. At every stage in starting and building a business, risks have to be taken and new skills have to be learnt. This provides the buzz that makes it exciting to be an entrepreneur.



Excitement comes from taking risks

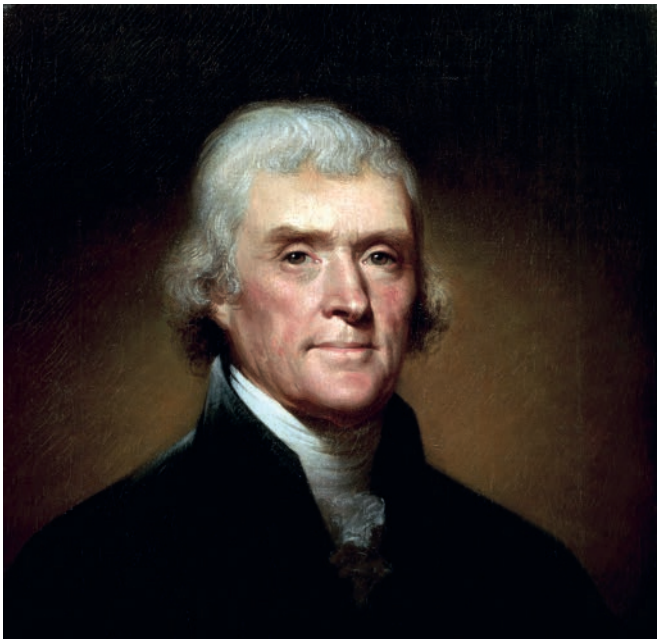
Profit and wealth

Starting a small business can generate huge returns. Most working people struggle to save much from their salary. They may be comfortable but can never become rich. Starting a business creates the possibility of selling it once it is established. It could be sold completely, or part of it could be sold to outside shareholders by 'floating' it on the stock market. In 2005, Tim Warrillow and Charles Rolls set out to launch new 'mixer' soft drinks into a super premium-priced sector above long-standing market leader Schweppes. Sales of Fever-Tree sodas went stunningly well, growing to more than £50 million by 2015 and more than £250 million in 2020. The founders sold some of their personal shares for more than £100 million in 2016, while still holding a dominant stake in the business. By June 2021 Fever-Tree Drinks plc was valued in the London Stock Exchange at £2,900 million.

Independence

Many people dislike being told what to do, especially if they do not respect their boss. For such people, starting up on their own may be ideal. By becoming **independent**, they can make their own decisions and, if necessary, their own compromises. People with this motivation may struggle if they start to employ others who have different ideas or standards from their own, however.

Risks in business (and in life) are unavoidable. Well-run firms think about the risks that they may face, and then estimate the possible impact. For example, the cost of a football team dropping out of the Premiership is said to be about £100 million. Apart from the top five sides, each of the other clubs will think about the chance of relegation and its cost. If there are three relegation places for 15 teams, there is a 20 per cent chance of relegation *every year*. So, a wise club chairman would have a plan for how the team would cope. Sadly, the experience of teams such as Nottingham Forest and Bolton Wanderers suggests that not every club does this.



'With great risk comes great reward.'
Thomas Jefferson, former US president

Talking point

If your parents spent the family's entire savings on starting a new pizza delivery business, how would you feel about the balance of risk and reward?

Drawing the right conclusions

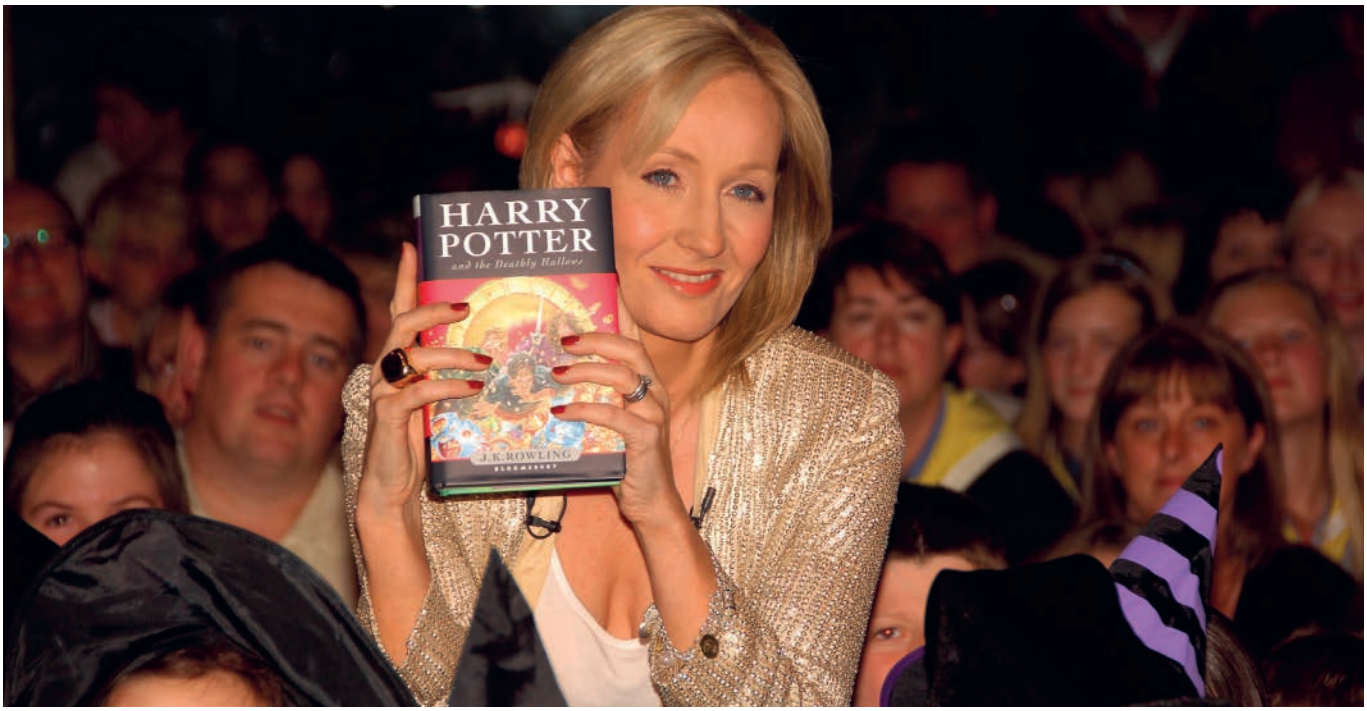
For a small firm there is more to consider than just **risk and reward**. There are also the consequences. When book publisher Bloomsbury risked a £2500 advance to JK Rowling, it was not going to break the bank, even if *Harry Potter* proved a flop. Needless to say, that risk brought Bloomsbury a reward measured in hundreds of millions. But if a small firm takes a big risk, failure may drag the business down.

Clearly, it is vital to think not only about the chance of something going wrong, but also the consequences. Apple can risk £500 million on a technology that may or may not work as £500 million is only 0.5 per cent of the money it keeps in its bank account. For a small firm, risking £10,000 may mean risking the whole future of the business.

Clever businesspeople therefore try to weigh up:

- the chances of success or failure
- the costs or benefits of success or failure
- the implications for the business as a whole.

Educated risks are the key to success.
William Olsen, chief executive



The *Harry Potter* series proved a great success for Bloomsbury after it risked a modest advance on author JK Rowling

Revision essentials

Business failure: the collapse of a business, probably leading to its closure.

Independence: the need by many business owners to make their own decisions and be their own boss.

Lack of financial security: uncertainty for the business owner about day-to-day family income and assets.

Risk and reward: the balance between the worst that can happen and the best that can happen.

End of chapter exercises

1 Outline two significant risks that might be faced by a small sports shop in your local high street over the coming year.

2 Richard Branson started his first business at school, launching *Student* magazine, before going on to found the Virgin group. Outline two rewards Richard Branson may have received from his initiative.

3 Using the information in Figure 4.1 on page 17, calculate partnerships as a percentage of all UK businesses.

4 Re-read the section on DW Sports in Table 4.2 on page 17. Outline two ways DW Sports might have become successful, despite the competition from The Gym Group and David Lloyd.

5 Outline the balance between risk and reward in the case of Bloomsbury's £2500 investment in JK Rowling.

6 Read the following extract and answer questions (a) and (b).

Skye and Ted Barton took over the family fish-and-chip shop when Skye's parents retired. The business kept them going financially but seemed to be going nowhere. Skye looked into buying the shop next door to create the space for a sit-down restaurant section. She was sure that would attract office workers at lunchtime. Her calculations showed that it would cost £18,000 and could generate an extra £9,000 profit a year. Ted rejected the idea, saying: 'You can't be certain. There's a real risk that your figures are wrong.'

(a) Describe Ted's attitude to risk.

(b) Explain why it is necessary for all businesspeople to be willing to take risks.

7 Elon Musk said: 'There's a tremendous bias against taking risks.' Which is the best explanation of why this may be so?

(a) Because it's foolish to take a risk if you're sure you can succeed without taking chances.

(b) People understand that innovators have to take risks, because they're looking into the unknown.

(c) Those paid a monthly salary won't risk it by making bold decisions.

(d) The cost of not taking a risk is rarely taken into account.

Practice questions

Scoop ice cream: risk and reward

On 1 January 2016, founder Matteo Pantani left Scoop ice cream. Outside investors had always owned the majority of the shares, and they decided to replace him as the company's chief executive. This was a risk Matteo had never expected. The shareholders were his friends. No more. For Matteo, all the struggles to make Scoop a success were wasted.

The business began when a London-based banker friend of Matteo phoned to urge him to come over 'because there's no good ice cream in London'. The banker would organise the finance and Matteo would use his skills to make and market great ice cream.

When Matteo approached estate agents about a central London location for an ice cream parlour, most turned him down. They had all seen ice cream shops enjoy a super first summer then collapse from negative cash flow during the winter. Landlords wanted their properties going to safer businesses that would keep paying the rent.

After a long time looking, Matteo found premises of the right size in Covent Garden, a busy area popular with both tourists and Londoners. By autumn 2008 Matteo's ice cream parlour, Scoop, was a great success. He opened a second, then a third, outlet in central London.

Between 2008 and 2012, Scoop did wonderfully well. Matteo always said that selling high-quality ice cream 'is like selling happiness ... £2 for ten minutes of happiness'. His thrill in running the business came from pride in his product, and in people's reactions to it. He was working 14-hour days, so needed to enjoy it!

Scoop ice cream was a battle between risk and reward

The first big problem for Scoop came in 2012, when the London Olympics seemed to suck visitors away from central London. Business was awful. Then rainy weather in 2013 and 2014 kept summer business quite weak. Meanwhile, from 2008 onwards more and more competition had been arriving in London: *gelato* (Italian for ice cream) had been an unusual word in 2008, but was now everywhere.

When 2015 proved another year of struggle to make substantial profits, the shareholders stepped in. After sacking Matteo they appointed a highly efficient manager whose job was to return the business to making profits. Costs were cut and the wide range of ice cream flavours started to diminish. So did the regular customers. By 2019 Scoop was closed down completely.

Total: 20 marks

1 Outline how the idea for Scoop came about. (2)

2 Define the term 'competition'. (1)

3 Outline one factor that was important in turning Scoop from a business idea into a business success in the beginning. (2)

4 Analyse the problems Scoop faced following the start-up period. (6)

5 Matteo is determined to achieve business success. He has two options:

- Option 1: Open a new Scoop, starting again, with no **outside** shareholders.
- Option 2: Start London's first ice cream school, offering 12-week training courses for those wanting to make gelato.

Justify which **one** of these options he should choose. (9)

5 The role of business enterprise

What is business for? While the individual entrepreneur may want to be the boss and to make money, the only way to do these things is to produce goods or services that people want to buy, or to meet customer needs or wants, in such a way that adds value (see Chapter 6, Adding value, on page 27).

The role of business enterprise and the purpose of business activity are one and the same: to produce goods and services that people want to buy.

> The purpose of business is to create and keep a customer.
>
> *Peter Drucker, management guru*

Goods or services

Goods are products, so they can be touched and held. Some goods are long lasting, such as furniture, cars and carpets. These can be used over and over again. Households buying such products will care about how long they last and perhaps what image the products create ('my iPhone', 'my BMW', 'my leather sofa'). Products have to be manufactured in some way, probably in a factory.

A selection of electronic goods

By contrast **services** are usually invisible and certainly can't be touched or held. In the UK, important services include retailing, health and nursing care, sports and leisure. As shown in Figure 5.1, services account for nearly 80 per cent of all the business done in this country. The same is true of most developed countries. By contrast, services account for little more than half of China's annual output.

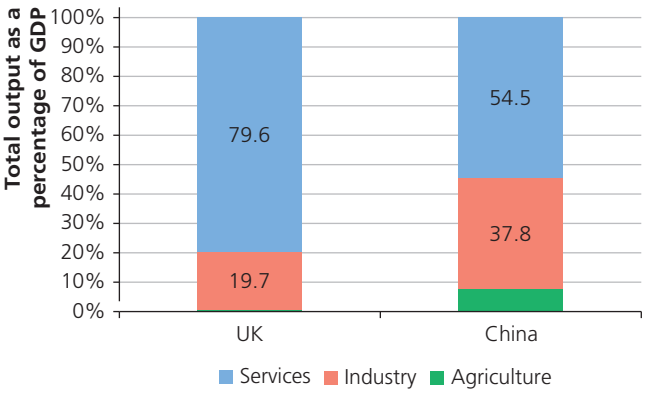


Figure 5.1 A comparison of products and services in the UK and China (Source: Statista 2020 and House of Commons Library 2021)

Producing goods requires a huge range of management skills. This is why successful businesses such as Fever-Tree leave production to others. They buy in the finished soft drinks from an established factory. Even when the products are made elsewhere, there's still a huge amount to do. A producer must:

- design the packaging, brand name and logos
- get the right **product range**: big enough to be interesting but not so wide as to end up with too many small sellers
- persuade shops to stock the product(s)
- once orders arrive, make sure deliveries are on time and accurate

Table 5.1 Examples of goods and services produced in the UK

Businesses producing/manufacturing goods	Businesses selling goods	Businesses creating services
Jaguar Land Rover	Tesco	Ryanair
Cadbury	Marks & Spencer	NatWest
Heinz	ASOS	Netflix
Panetteria Italiana (my local baker)	Game	Depop

- design, write and run consumer advertising and promotions, to help make sure that your retailers enjoy big enough sales to keep stocking the product(s)
- get the invoicing right, that is, make sure customers pay the right amount, on time.

Services are also a business challenge. Opening a shop or a restaurant may require £50,000 or more in start-up capital, and there are risks aplenty. The most worrying risk is that the business may fail to generate enough day-to-day profit to cover the sometimes huge costs of rent, business taxes and staff salaries. For a small cafe space in London, the rent might be as high as £60,000 a year. If those costs can't be covered, the business will collapse, perhaps leaving sizeable personal debts.

Another possibility is that the business is OK, but not making the level of profit that had been expected. Many businesses keep going for years like this, just ticking over.

Online and hybrid estate agents can be particularly lucrative

Happily, there are also some great success stories:

- Ever since she was ten, Jordan McCabe's ambition was to start a business designing and making clothes for horse riders. Today her company has close to £500,000 of cash in its bank account – and she has customers worldwide.
- Hybrid estate agent Purplebricks saw **sales revenue** jump by more than 2500 per cent, from £3.4 million in its start-up year of 2015 to £90.1 million in 2021.

Talking point

Some firms take 10 years to achieve revenue of £0.5 million. Purplebricks managed to reach £90.1 million in six years. What might explain the different growth rates?

Meeting customer needs and wants

Businesses like to say that they meet **customer needs**. Actually, many businesses provide what we don't need but do want. Consider Cadbury for starters. When writing about business it is important to remember that companies present themselves in the best possible light. They prefer to say 'we fulfil needs' than 'we encourage people to buy what they shouldn't'.

An example of a business that fulfils customer needs is a provider of commuter rail services. People need to get to work and there may be no other realistic option. So they go by train. Because few commuter rail services face any competition, train operators are able to provide a poor service with little danger of losing customers.

In many other cases, customer needs are met by businesses that face competition and therefore have

to give their best. Someone who wants a pint of milk can probably pick between five and ten places that sell it. To make sure that customers return, they need a well-lit, clean shop, with fast and friendly service.

When it comes to meeting **customer wants**, companies have to do even more. They have to persuade people to buy and then persuade them to keep coming back. This is likely to require powerful advertising, high-quality customer service and terrific distribution.

> Being on par in terms of quality and price only gets you into the game. Service wins the game.
>
> *Tony Alessandra, US entrepreneur*

Drawing the right conclusions

In the best companies, meeting customers' wants and needs is a pleasure, not a burden. A happy customer should give pleasure to the workforce, just as a satisfied student makes the teacher's job worthwhile. Some companies are great at keeping everyone focused on the customer. Greggs and Pret a Manger are good examples.

To make sure customers get the products and services they want, companies may:

- hire new staff on the basis of attitude and personality, rather than whether they have great experience, as they'll give friendlier service
- invest heavily in research and development to try to find new products and new technologies
- start a business on the basis of what the founders love doing rather than what they think will make money.

Revision essentials

Customer needs: the products or services people need to make life comfortable.

Customer wants: what people choose to spend their money on, once the weekly bills have been paid.

Goods: products that may be grown, such as apples, or manufactured, such as Heinz Baked Beans.

Sales revenue: the total value of the sales made within a period of time, such as a month.

Product range: the number of different product types, sizes, colours and brands offered by a company.

Services: providing useful ways to help people live their lives, for example shops, restaurants and hospitals.

End of chapter exercises

1 Why might it be more expensive to start up as a manufacturer of goods than as a service business?

2 **(a)** Using the information in Figure 5.1 on page 22, calculate the amount of the UK's national output that is generated by agriculture; then do the same for China.

(b) Outline why this information may be important to a producer of tractors.

3 Why may richer, developed countries have only a small percentage of national income coming from farming or fishing?

4 Outline why it might be hard to get a shop to stock a brand-new product for the first time.

5 Read the following extract and answer questions (a) and (b).

The website for belVita tells us that the company is 'passionate about breakfast biscuits'. What? Passionate? It also shows that these biscuits typically contain 400 calories per 100 grams – more calories per gram than Coco Pops! That seems a lot given that belVita promotes itself in ways that imply a healthy start to the day. Owner Mondelez has managed to do a clever job in making customers want belVita. In 2020, UK customers spent £80 million on belVita biscuits.

(a) Could Mondelez make a case for saying that belVita biscuits are a need, not a want?

(b) Explain why it is important for consumers to think carefully about whether they really need what they want.

6 Which of the following businesses produces goods and which produces services? (6)

	Goods	Services
(a) Mars, producers of Galaxy chocolate		
(b) The publishers of *The Sun* newspaper		
(c) John Lewis Partnership, owners of Waitrose		
(d) Aston Villa Football Club		
(e) Coca-Cola Inc., owners of Innocent Drinks		
(f) British Airways		

Practice questions

A gripping need

In 2014, at the age of 18, Jordan Daykin became the youngest person to get investment in the TV series *Dragons' Den*. Deborah Meaden invested £80,000 in return for a 25 per cent stake in GripIt. Today the business has been valued at over £13 million. Deborah has done well.

Daykin's pitch was based on a classic consumer need. More and more interior walls are built of plasterboard, but there was no safe way to hang items such as TVs or kitchen cupboards on it. Jordan (and his grandfather) came up with a design that worked. A GripIt fastener can hold a quarter of a ton in weight. Other dragons were worried that the market for wall fastenings would be too small. Happily, the need was the same in the USA, and Daykin succeeded in getting distribution in the 2000-branch US DIY chain Home Depot. The even bigger Wal-Mart seemed keen to follow.

What Meaden loved about GripIt is that it is 'a classic invention – one that solves a problem in a practical and affordable way'. But after several years with sales of more than £1 million, the business ran out of cash in 2019. After a desperate attempt to raise an extra £1 million from a crowdfunding site, the licence to all GripIt products was sold cheaply to established manufacturer Charles Bentley & Son in November 2019. The pessimistic dragons were proved right.

Total: 20 marks

1 Outline one problem in producing goods that may have caused difficulties for GripIt. (2)

2 Apart from meeting a consumer need, analyse other possible factors that may have persuaded Deborah Meaden to invest in GripIt. (6)

3 If Deborah Meaden was asked whether investing in GripIt was a mistake, she might say that the business met a real customer need. Evaluate whether a business is worth investing in purely for that reason. (12)

GripIt: business success or mistake?

Practice questions

The Vegan Kind

In April 2021 online vegan supermarket The Vegan Kind raised £3.5 million from investors. Between its start-up in 2013 and 2020 the business had grown by 'bootstrapping', meaning getting no external capital to fund growth. Then came a £650,000 investment in March 2020, just as the Covid-19 lockdown loomed.

Husband-and-wife team Scott and Karris McCulloch started their company as a subscription delivery box business in 2013. Steady expansion meant offering more customer choice until, by 2018, they could call it a vegan supermarket. In October 2020 The Vegan Kind's new, 35,000 sq ft warehouse opened – to keep up with booming demand. The twin pressures for plant-based food and online purchasing made 2020 a breakthrough year for the business. The website now averages 200,000 visits a month and offers customers next-day delivery on a range of 6000 plant-based items. The website says a tree is planted for every order received. The McCullochs clearly know their target market. But how will they use the extra £3.5 million?

Total: 20 marks

1 State whether The Vegan Kind is a product or a service. (1)

2 Outline a problem The Vegan Kind may have in providing 'a range of 6000' items. (2)

3 The business has 200,000 web visits a month. Analyse the factors that would be important in turning those visits into orders. (6)

4 If Scott and Karris own 51 per cent of the shares between them, and the business is valued at £6 million, calculate the value of the shares held by each of them. (2)

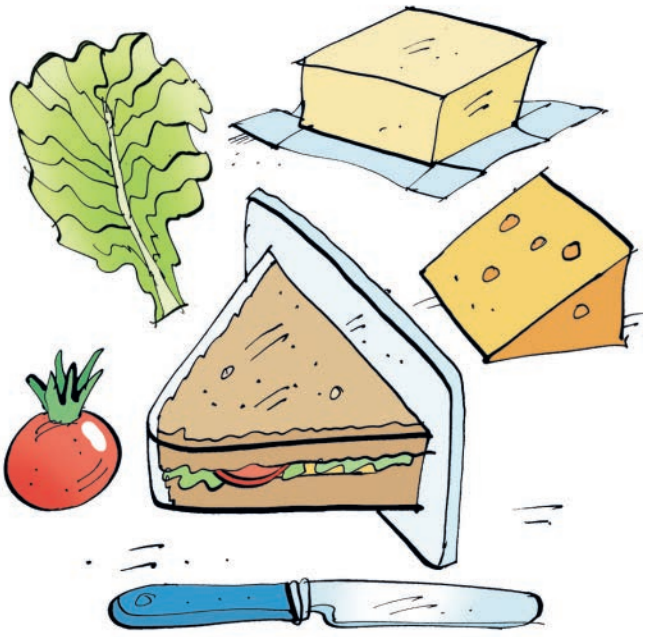
5 Scott and Karris are discussing two options for the £3.5 million:

- Option 1: Invest in people, hiring experts in stock control, marketing and other specialities.
- Option 2: Invest in a completely new, speedy-to-use website linked to an m-commerce app.

Justify which **one** of these options they should choose. (9)

6 Adding value

Many shops sell Walkers crisps at 50p per pack. The pack weighs 35 g, which is about 2p of potatoes. Oil, salt and flavouring are also used, but even adding in the cost of the packaging, the total cost per unit is no more than 4p. So, turning potatoes into crisps adds value. It 'creates' value by making the customer willing to pay extra. In the case of crisps, turning 4p into 50p adds 1150 per cent to the value of the potato (46 / 4 × 100). That's good business.



A sandwich is more than its ingredients – it has added value

Is adding value a rip-off? Not necessarily. A sandwich sold for £2 may contain ingredients costing 40p. So the baker is receiving £1.60 for two slices of bread. Assuming there are 20 slices in a £1 loaf, that's selling a loaf of bread for £16 instead of £1. When people are going out, however, they do not want to take butter, cheese, tomato and a knife with them. They would rather buy a sandwich. They are happy to pay for speed and convenience.

> The real issue is value, not price.
> *Robert Lindgren, Harvard Business Review*

How to add value

Added value is the difference between the cost of materials and the selling price. Value can be added either by pushing the price up or by cutting the costs. Usually it is by adding in a feature that makes the item more valuable to the customer, which enables the price to be increased.

Different ways to make an item more valuable to the customer:

- Convenience and speed: in Britain, most people will pay extra to save their own time, as shown in the table below. People are willing to pay four times the amount to buy an item in a restaurant to avoid the cooking and clearing.

Table 6.1 Adding value by adding convenience

Chicken curry and rice	Price per person
Cook your own	£2.00
Add Sharwood's bottled sauce to chicken	£2.50
Buy supermarket ready meal	£2.75
Buy a takeaway	£4.75
Go to a restaurant	£8.00

- Good **design**: a beautifully designed dress might sell for £200, while one using exactly the same quantity of material might sell for just £20.

Nike's brilliant branding

- High-quality manufacture or service: a Lexus costs £70,000 because it is regarded as one of the best-made cars in the world; it never breaks down and is like sitting in a huge leather armchair.
- **Brand name**: a Nike swoosh adds tens of pounds to the 'value' of a pair of trainers; a Mercedes badge on the front of a car adds thousands of pounds to the value of a new car. At the start of 2018, TikTok was unknown in the West. Today it has more than 1 billion users – and fantastic brand recognition worldwide.

> A brand is no longer what we tell the consumer it is – it's what the consumers tell each other it is.
>
> *Scott Cook, founder of Intuit*

- **Unique selling point (USP)**: an original feature that competitors aren't offering; something that makes the product worth paying extra for (for example, a family car with flat-screen TVs and headphones on the back of the front passenger seats).

> In order to be irreplaceable one must always be different.
>
> *Coco Chanel, fashion designer*

Talking point

How could you add value to a white T-shirt?

The importance of value added

People starting businesses often forget about the everyday costs. There are obvious ones, such as electricity and phones, but also others, such as the cost of 'wastage' (theft plus damaged goods) or the cost of recruiting and training new staff. All of these costs have to be paid for out of the **value added**. So there needs to be a big enough difference between price and bought-in costs to allow internal costs to be paid for. The fashion clothing company Ted Baker adds £285 million of value to its £185 million of bought-in costs (such as clothes made by outside suppliers). The bar on the right of Figure 6.1 shows how the value added pays for all the company's costs, including the tax on profits.

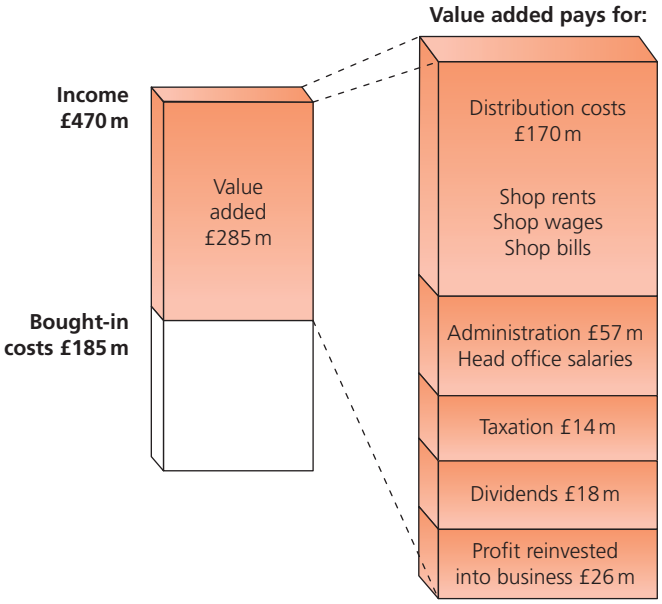


Figure 6.1 What the value added pays for at Ted Baker

As the diagram shows, value added is a necessity in business, not a luxury. Value added pays the wages, pays the bills and generates the profit needed to finance future growth. When starting up, every firm needs to think hard about whether the business idea adds enough value to be profitable.

These are some business ideas that may have a market but do not have enough value added to be worthwhile, for example:

- hand-washing cars
- babysitting
- delivering milk to people's homes.

Delivering milk doesn't have enough value added to create a good enough business

Good businesspeople recognise that high value added comes from clever ideas, presented well and delivered efficiently. That, in turn, makes it possible to run a sustainable, profitable business.

Drawing the right conclusions

Value added is at the heart of all business activity. Therefore, it can be used to develop answers to lots of different business questions. It will come up regularly as a 9- or 12-mark question in itself, and will be useful when tackling many other exam questions. The key is to remember that value added can be created by psychological factors, such as brand image ('I must have Apple/Nike/Versace'), or by practical factors, such as quality of design or quality of manufacture.

Revision essentials

Branding: giving a product or service 'personality', with a name and logo that makes it stand out.

Design: deciding how something will look, both internally (the gearbox) and externally (the boot).

Unique selling point (USP): an original feature of a product that rivals aren't offering.

Value added: the difference between the selling price and the cost of bought-in goods and services (the difference that creates the possibility of profit).

End of chapter exercises

1 Why does a company's added value matter to its employees?

2 Briefly explain the sources of the added value in these cases:

(a) a £5 box of Celebrations chocolates

(b) a £54 ticket to see Chelsea play Manchester City

(c) a £3 cup of coffee at Starbucks.

3 Identify the USP that each of these firms is keen to establish:

(a) Ryanair

(b) L'Oréal.

4 What might be the consequences of Ted Baker deciding to increase value added by cutting its £185 million spending on the clothes it buys in from suppliers?

5 Read the extract and answer questions 5 and 6 (a)-(b).

The Oban Chocolate Company began in November 2003, backed by £9,500 of funding from a local Scottish Islands enterprise agency. At their shop, cafe and factory premises in Oban, Helen Miller and Stewart MacKechnie make handmade chocolates in the basement for sale upstairs. Good quality chocolate is

not cheap, but by making fancy, unusual products such as 'hot chilli truffles', value is added. Visitors also get a whole experience, including a visit downstairs to see the chocolates being made. In 2019 it received an average review rating of 5/5 on Facebook. Today the business employs five full-time staff. In the past its problem was that relying on tourists meant little trade during six to eight months of the year. Today, online sales keep things going in the colder months – especially at Christmas, Valentine's Day and Easter.

Outline two factors that create added value at the Oban Chocolate Company.

6 High value added is great for a business, but only if sales volumes are also high.

(a) Why may the Oban Chocolate Company have a problem?

(b) What might they try to do to increase their sales volumes?

Practice questions

Value added burgers

Callum and Jamie were bored with work. Both 21 years old, they had trained as plumbers but working for British Gas was getting dull. Jamie heard that there was a snack wagon for sale – fully equipped with gas, electricity and a fridge – and within three days they had found £3,000 each to buy the van. Their plan was to place the van permanently on a busy road between Wimbledon and Croydon, then employ someone to do the cooking. Callum and Jamie's role would be to keep the van supplied and to make key decisions, such as pricing.

The pricing decisions were largely drawn from their experience of local snack bars: teas and colas at around £1, big burgers at about £3 and the occasional item rising above £4. They were able to set down a few details, as shown in the table below.

In addition to these costs, there would be fixed overhead costs such as rent, energy and labour costs. They allowed £500 per week for these.

They served their first burgers in April and by October were making a modest profit. That same month they sold the business for £10,000. They had decided to move to Spain to make a living from plumbing, and later start up their own plumbing business.

Total: 25 marks

1 (a) Calculate how much value is added by making a cup of tea at this snack wagon. (2)

(b) Outline why it would be wrong to call this value added figure 'profit'. (2)

2 Outline one way in which Callum and Jamie might have added more value to their snack bar. (2)

3 Identify the cost of ingredients for making a burger at Callum and Jamie's snack bar. (1)

4 Analyse how a good location can add value to a business such as Callum and Jamie's. (6)

5 Evaluate whether Callum and Jamie are likely to be able to create more value added with their second business. You should use the information provided as well as your knowledge of business. (12)

Table 6.2 Components and costs

Item	Components	Bought-in costs per unit	Selling price
Cup of tea	Tea bag, milk, sugar, plastic cup, spoon	12p	£1.00
Burger	Frozen hamburger, onions, bun, ketchup, paper napkins	40p	£3.00
Chips	Frozen chips, oil, paper cone, salt, vinegar, ketchup	30p	£1.50

Practice questions

Adding vegetable value

Emily vegetable crisps

When a sweetshop sells you a Twirl for 65p that cost them 50p to buy from the cash and carry, they've added 15p of value. That's 30 per cent of 50p. It may sound good, but remember that the business still has to pay its rent, its business rates, the electricity, the phone bill and perhaps a wage bill. And if there's any profit at the end of the year, tax also has to be paid on that. It's no wonder that clever entrepreneurs think a lot about value added before they invest in a business start-up.

A classic for high levels of value added is the market for crisps and snacks. Emily Wong saw an opportunity in the growing market for vegetable crisps, which customers believe to be healthier than potato crisps. She started her brand Emily in 2014, growing it to the point where she was able to raise £1 million in crowdfunding finance in 2018. Strong finance and stand-out packaging has helped her build distribution up to more than 5,000 UK shops. Table 6.3 below shows the remarkable levels of added value available in this market. You can safely assume that vegetables such as sweet potato, carrot and beetroot cost no more for the company to buy than raw potatoes. So, in the case of Emily Crisps, this added value should translate into profit.

According to Table 6.3, Walkers Crisps can turn 5p of potato into £1 of crisps, suggesting added value as high as 20-fold. Even Lidl's own-brand crisps are making money on this basis. And what of the healthiness of the different products? The table gives a good insight into that as well.

Total: 19 marks

1 Outline the role of a business enterprise such as Emily Crisps. (2)

2 Analyse the table of data to decide whether Emily can focus more heavily on the health benefits of her vegetable crisps. (6)

3 Based on knowing that the implied value added for Walkers was 20-fold, calculate the value added on Emily Vegetable Crisps. (2)

4 In the future, Emily wants to add more value to her products to support the high prices of her crisps. One option is to focus more on convenience. A second option is to focus more heavily on branding. Justify which **one** of these two options Emily should choose. (9)

Table 6.3 The levels of added value available in the market for crisps and snacks

	Pack weight	Price per pack	Price per 100 g	Calories per 100 g**	Fat per 100 g**	Saturated fat per 100 g**	Sugars per 100 g**
Emily Vegetable Crisps* Waitrose	80 g	£2.60	£3.25	483	22.2	11.3	23.6
Kettle Chips Waitrose	150 g	£2.00	£1.33	513	29	3.3	1.5
Walkers Crisps Waitrose	6-pack × 25 g = 150 g	£1.50	£1.00	528	32	2.8	0.8
Snaktastic Crisps Lidl	6-pack × 25 g = 150 g	65p	£0.43	472	16	Not available	4.0
Raw potatoes Lidl	2.5kg	£1.25	£0.05	70	0.1	0	0

*Sweet potato, carrot and beetroot
**Nutrition data as set out on company websites

7 The role of entrepreneurship

An entrepreneur is a **risk taker** who wants to create an organisation that can make a difference. That difference may be for a social reason, such as the bottled water brand One, founded by Duncan Goose to generate profits for a social purpose: funding water charities in Africa. Or it may be because the entrepreneur wants to become very, very rich.

Many people talk about making a difference. The entrepreneur acts on the brilliant Nike slogan 'Just do it'. The phrase sums up the key enterprise skill, which is to make things happen.

Being enterprising means spotting an opportunity and then having a go. Of course, this could be disastrous. A family may be rescued from a mountainside, having gone climbing without proper equipment or training. In this case 'let's just do it' is reckless. Similarly, businesses are set up by people who have no expertise, no skills and not enough capital. Yet a few examples of stupidity should not put people off. Bold ideas lead to exciting lives and potentially huge rewards – emotionally and financially.

A family may be rescued from a mountainside, having gone climbing without proper equipment or training; in this case, 'let's just do it' is reckless

An entrepreneur:

- takes risks
- makes **business decisions**
- organises **resources**.

As shown in Figure 7.1, the attitudes and confidence of potential entrepreneurs vary considerably from country to country. The UK is among the most

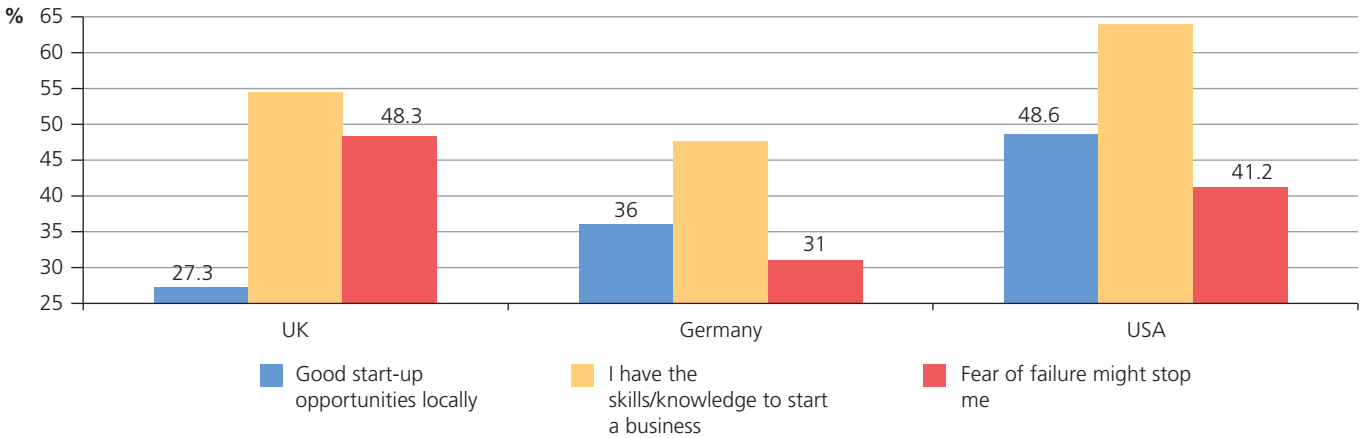


Figure 7.1 Attitudes to entrepreneurship (Source: Global Enterprise Monitor, 2020/2021)

entrepreneurial in Europe, but nowhere close to the USA.

Taking risks

As set out in Chapter 4, risk is about chance. Wealthy dragons in the TV show *Dragons' Den* can use this knowledge in comfort, knowing that if they put £100,000 into ten different businesses, six may fail, three do reasonably well, and one make millions. But each of the ten entrepreneurs involved has only one of those ten chances. Six may use up their family's entire savings on a business venture that fails. Horrible. Three end up wondering whether all the hard work was really worthwhile. And just one ends up on a Caribbean island.

And there are many more risks involved than the start-up one of 'should I do it or not?' Every day the entrepreneur has to make decisions in a state of uncertainty. The reason is simple: when you're starting your first business, you haven't faced these questions before. And sometimes you'll do the wrong thing. And while some individuals would struggle with that failure, a true entrepreneur shrugs their shoulders and gets on with the next decision. Success comes from facing up to decisions and getting the big ones right, most of the time.

Dillons was taken over by Waterstones

> Do you want to be safe and good, or do you want to take a chance and be great?
>
> *Jimmy Johnson, Dallas Cowboys coach*

Making business decisions

Decision making is crucial, not only in response to opportunities but also in response to difficulties. A hairdresser with three outlets may have one that is losing money. Decisions are required. Perhaps the outlet should close, or perhaps it needs a revamp. When the bankrupt bookstore chain Dillons was taken over by Waterstones, over half the shops were found to have been losing money for years. But no one did anything about it!

To make decisions successfully, the key is to find out as much information as possible, from as many sources as possible. Most important are your staff and your customers. Ask for views and opinions, then decide, and carry the decision through without hesitation. In big organisations decisions are often put back and put back; in new small businesses, there's no time to lose. Even if the decision proves wrong, there's a lot to be said for knowing quickly, so that the decision can be reversed before competitors have had time to respond.

> A ship is always safe at the shore, but that's not what it was built for.
>
> *Albert Einstein*

Showing leadership

Leadership has a lot to do with qualities such as decisiveness, initiative and the ability to think ahead. Another important element is the personality and the character to make people believe in you. This might be helped by self-confidence, but some excellent leaders are actually quite shy. Some are great at one-to-one chats, but less comfortable when speaking in public or when chatting in a group of people. Although Richard Branson comes across very well on TV, he is said to be very shy and often tongue-tied.

Good leadership needs to be based on good judgement about the right decision or initiative, plus the determination to see things through. It also requires an ability to make people want to share the leader's path (that is, to help achieve their aims). This requires either charisma or the ability to make people respect and believe in them.

Talking point

The number of business start-ups in the UK has grown significantly in recent years. Why might that be?

Organising resources

At the start, entrepreneurs are usually on their own. They have to do everything, from making decisions to making the tea. Yet to put a start-up together requires a huge range of skills, contacts and know-how. Even opening a small cafe means organising resources across a wide spectrum of business life:

- physical resources, such as choosing the right premises; briefing the builders; designing the kitchen and the interior, and getting it built and decorated; choosing, buying and installing equipment from cookers and tills to chairs and tables
- buying daily resources such as crockery, cutlery, containers, ingredients, drinks, till rolls and toilet rolls
- hiring the right **human resources**, especially a reliable, competent cook who can help compile a menu and work out prices, plus other waiting and cooking staff.

Eventually, managing these resources will become second nature, and perhaps dull. Stelios Haji-Ioannou founded budget airline easyJet in 1995, but stopped running it after five years because it was getting too routine. He hired a top class manager to take over as chief executive instead. Before they become bored though, entrepreneurs have to be masters of a wide range of skills, becoming as good at hiring (and firing) as they are at pricing and planning. Organising human and physical resources is a critical skill. Table 7.1 below shows why.

Table 7.1 Seven main causes of start-up failure

Reason	Brief explanation
Starting the business for the wrong reason	Those starting up to 'make money' or to 'have more time with family' are the most likely to give up. Those with a passion for their business are most likely to succeed.
Poor management	Weak management of resources – physical and human – is a major reason for failure. Simple things like security and fraud must be handled with care.
Insufficient capital	Both the costs of starting up *and* the costs of staying in business must be factored in. Profits rarely come quickly.
Poor location	Critical for a service business such as a restaurant. It is best to go to where the customers are than to expect them to come to you.
Lack of planning	This goes hand in hand with poor management, but focuses more on whether enough time, thought and research was put into the business in the first place.
Overexpansion	A boom in sales is both a thrill and a danger for an entrepreneur. Problems of managing resources escalate when business is booming.
No (or poor quality) website	A good website helps customers to find you, or re-find you. It gives an image of professionalism and allows convenient communication or purchasing. Bad ones don't!

Drawing the right conclusions

The role of the entrepreneur is a remarkable one, requiring business skills and personal qualities that will all be tested fully. Some entrepreneurs learn quickly about their own weaknesses and hand over to a new person for the day-to-day management of the business. Just a few, such as Ben Francis, founder of Gymshark, stay at the helm as the business expands.

Revision essentials

Business decisions: choices that have to be made, usually within a short time period.

Human resources: a term used by organisations that simply means employees.

Resources: things or people that can be used to help build and run the business.

Risk taking: making decisions where unknown factors or chances of failure loom large in the decision-maker's mind.

Ben Francis, founder of Gymshark

End of chapter exercises

1 What might be attractive to entrepreneurs about taking risks?

2 Look again at Figure 7.1 on page 33 then answer these questions:

(a) Calculate how much more confident Americans are than those in the UK that they have the skills for start-up success.

(b) People in which country most fear start-up failure?

3 Why might an entrepreneur find it hard to manage the human resources needed for business success?

4 Read the following extract and answer questions (a)-(c).

After 14 years working for TV chef Rick Stein, Paul Harwood started up The Fish House restaurant in Newquay, Cornwall. He had to organise the finances, the building work and all the resources in order to get the business underway, and then start cooking – he is a chef–proprietor. Prices have been kept low to build up a base of customers rather than relying on August holidaymakers. The location of the restaurant is right on Fistral Beach, boasting beautiful views. The location has a spin-off benefit for Paul too, as he is as passionate about surfing as he is about cooking.

(a) Outline one decision made by Paul Harwood that you think should help the business succeed.

(b) Outline two factors that may generate value added for The Fish House.

(c) Why may Paul Harwood find the life of a chef–proprietor a bit of a shock?

Practice questions

Staff: the most important resource

For most businesses, the early weeks after opening are the most painful financially. Months of big spending to get the business started are followed by loss-making weeks as customers wait to hear from others whether the new place is any good. Not at Waffle Jack's. From 7 a.m. on day one customers kept coming. A crazy morning rush from boys going to the nearby secondary school was followed by locals interested to try this new American-style diner. The menu was certainly accessible – waffles, burgers and shakes – and had a huge array of options (such as six types of burger bun).

For entrepreneurs Adele and Stephan Theron the success was both wonderful and shattering. Waffle Jack's opening hours of 7 a.m. to 11 p.m. seven days a week would be bad enough, but they also owned a cafe about ten minutes' drive away. The pressure was immediate – but luckily both knew enough about start-ups to understand the pressures.

Within a week of starting up, Stephan was already clear about his main problem – staffing. Two staff quit by the end of the week – they found the never-ending queues too stressful. Since then, Waffle Jack's has continued to have plenty of customers, but staff coming and going is a real strain. Few local British workers have lasted more than a week or so, leaving other EU nationals to keep things going. The 2021 Brexit controls on migration from the EU made Stephan's life that bit more difficult.

Total: 13 marks

1 Outline one possible reason why managing human resources may be the hardest problem for entrepreneurs. (2)

2 Outline one important decision that Adele and Stephan need to make. (2)

3 Stephan is thinking ahead to how best to maintain the growth of Waffle Jack's. He sees two options:

- Option 1: Build a barbecue cooking and eating area at the back of the premises to generate higher evening revenues.
- Option 2: Open waffle-only Waffle Jack's kiosks in busy city sites, such as London's West End.

Justify which **one** of these options they should choose. (9)

Exam-style questions on Topic 1.1

Don't rush; check your answers carefully.

1 Which **one** of the following explains the term 'venture capital'? (1)

(a) The centre of global enterprise: Silicon Valley, California.

(b) Providing risk capital to a young business.

(c) When a business puts its own capital at risk, for example when buying new machinery.

(d) Obtaining capital for an extreme sports company.

2 Which **one** of the following gives the correct meaning of USP? (1)

(a) United Service Providers

(b) Unique Service Point

(c) Unique Selling Point

(d) United Sales Proposition.

3 Which **two** of the following are important in creating a successful manufacturing business? (2)

(a) Using market mapping to find out your customers' likes and dislikes.

(b) Using franchising as a way of stopping others copying your ideas.

(c) Adding value by keeping your costs as low as possible.

(d) Analysing the key features of what your competitors offer.

(e) Making sure you keep your added value low enough to make a good profit.

4 Which **two** of the following are important roles for a successful entrepreneur? (2)

(a) Having enough capital to start up the business without need for more, external finance.

(b) Making business decisions.

(c) Has a creative mind.

(d) Organises resources.

(e) Able to bounce back from setbacks.

5 Which **one** of the following is a reason why a change in technology might lead to new business ideas? (1)

(a) Because the change cuts the cost of producing existing product lines.

(b) Because the change enables more units to be produced within the working day.

(c) Because the change requires new techniques to be learnt by staff.

(d) Because the change allows production of things that were impossible before.

6 Which **two** of the following businesses offer services, not goods? (2)

(a) A dairy farmer

(b) A shoe repair shop

(c) A baker

(d) A travel agent

(e) A car manufacturer

7 Which **one** is the best explanation of the word `obsolete', as in obsolete product? (1)

(a) It's no longer in fashion.

(b) It still works but only just; it needs replacing.

(c) Its brand name is no longer as trendy as it used to be.

(d) It's out of date technically.

8 Dre has opened a stall selling Fruit Slushies. The mango version contains half a mango (juiced in front of the customer), lots of ice chips and a squeeze of lemon. It's served in a paper cup with a paper straw and lid. He charges £4.00. Mangoes cost him 60p each, the ice is 10p and the cup, lemon, etc. cost 8p. The electricity cost to blitz the drink is 2p.

What is the value added per Mango Slushie? (1)

(a) £3.50

(b) 800%

(c) £3.20

(d) 500%

9 What harm may producers cause if they focus on wants rather than on needs? (1)

- **(a)** They may fail to sell as many items as they would if they targeted needs.
- **(b)** They may stray away from their target market.
- **(c)** They may encourage consumers to buy too much of what they want but don't need.
- **(d)** They may spend too much on ingredients and packaging.

10 Which **one** of the following is a serious business risk? (1)

- **(a)** Generating a far higher revenue than expected.
- **(b)** Cutting costs, which may push a profit into a loss.
- **(c)** The failure of a rival, which may cause its customers to come to you.
- **(d)** Business losses which may cause a sole trader to risk losing her house.

Now try this discussion question.

11 Discuss why entrepreneurs are willing to risk starting their own business, even though half of new businesses fail within 5 years. (6)

8 Customer needs

For a business to be successful, it must understand what customers need. There are six main areas to consider:

1 Price: For most people, most of the time, price is a critical factor in purchasing. A family holiday can cost between £1,000 and £5,000, depending on location and accommodation choice (camping versus three-star hotel versus five-star hotel). There are plenty of families who need the price to be towards the lower end, so a company focusing on low-cost holidays may be fulfilling an important customer need. The UK's supermarkets have realised that customers need a range of prices and options across all product lines. During the week we may buy 'value' pasta and sauce; at the weekends we may buy top-of-the-range meals costing five times more. What shoppers need is choice.

Aldi's share of the UK grocery market has grown in recent years

2 **Quality**: When Aldi and Lidl started growing in the UK, their rivals thought that customers were shopping for cheap items. Then both supermarkets became prize winners at *The Grocer* magazine's annual Own-Label Awards, outshining expensive

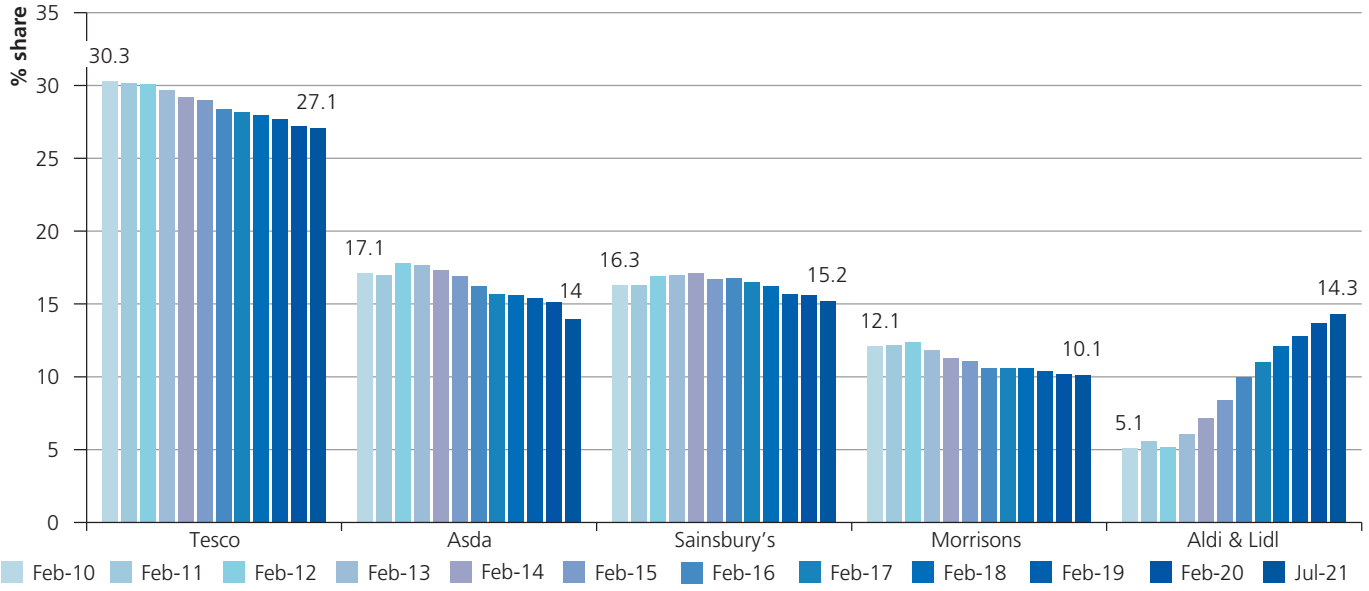


Figure 8.1 UK grocery market share, 2010–21 (Source: Kantar Worldpanel, 12 weeks to date stated)

Waitrose and Marks & Spencer. Only after seeing this did Tesco and the others accept that the German discounters were as much about quality as price. Figure 8.1 on the previous page shows how well Aldi and Lidl have done – and at whose expense.

Lidl has enjoyed an increase in popularity in recent years

3 **Choice**: Consumers love choice, even though it can sometimes be hard to make decisions in the face of 'too much' choice. Not only does choice mean that we may be able to find exactly what we want, choice also implies plenty of suppliers, meaning high competition and, hopefully, low prices. The problem for the producer is that choice can be punishing. For Cuckoo Foods, with sales of £400,000 a year, producing five flavours of muesli means inefficiencies of purchasing, production and stock levels. But the customer comes first.

> You expect to be waited on hand and foot, well I'm trying to run a hotel here.
>
> *Basil Fawlty, fictional hotelier in sitcom Fawlty Towers*

4 **Convenience**: Trade magazine *The Grocer* reports on customer service at the UK's supermarkets. Each week a secret visit is made to all the main stores in a different town, and a winner is announced: the shop of the week. Judging is based on how well each store meets customer convenience. The main factors are:

- a full range of stock
- short queues at the checkout
- a clearly laid-out store.

Different factors will be the key to success in meeting customer needs in other businesses. Table 8.1 on page 42 sets out some of the possibilities.

Good customer service is one of the keys to success

5 Being efficient and reliable: Customers want their needs met consistently. The trains on the London–Manchester route are smart, new and fast. This meets many customer needs. They also have a highly varied pricing policy, which lets students travel for £30 return while businesspeople may pay up to £369.40 to be on the same train. No one will be happy, though, if the service is unreliable. Success relies on careful planning and an eye for detail. In the case of a railway or an airline, engineers should make regular checks to prevent things going wrong, rather than waiting to fix things that have broken down.

6 Providing great design: Many customers value design and style above price. They want clothes that make them look great, cosmetics that make them look older – or younger – and cars that make them look successful, or exciting, or smooth. As discussed below, it boils down to getting close to the customer.

Table 8.1 Meeting customer needs

Business situation	Keys to meeting customer needs
Cafe in university student area	Cheap, with generous portions; open until late; internet access; some reference to organic or fair trade items
Dentist	Minimum wait; minimum pain; minimum sense of guilt (at too many sweets or too little flossing)
Buying a new Volvo car	Friendly, efficient service; reliable car that's easy or fun to drive; terrific sound system; petrol usage less punishing than expected
Manufacturing scarves	Great designs to meet different people's needs; different price levels: £6.99 scarves for teenagers, £19.99 scarves for middle-aged customers; making sure stock is available, especially in the autumn
Professional football club	Three points this Saturday, no matter how poor the game; the pies and the programme

Some people will only buy the best; others want £2.99 T-shirts for some days but £24.99 tops for Friday and Saturday nights. Well-run businesses learn what customers want, then recruit people with the right skills to be able to supply them.

> To all our nit-picky, over-demanding, ask-awkward-questions customers: Thank you, and keep up the good work.
>
> *Dell Computers advertisement*

Many customers value design and style above price

Importance of identifying and understanding customers

When Disney launched its streaming service Disney+ in late 2019, the company forecast that it might achieve 60–90 million subscribers in four years. This seemed bold as it had taken Netflix ten years to reach 100 million paying customers. But Disney understood its market, and beat the 90 million figure in just 16 months. By mid-2021 it was at 104 million subscribers and setting its sights

Disney+ off to a brilliant start

on overtaking Netflix as the world number one. So far, the great success for Disney+ has been a very low drop-out rate. Customers who try it become regulars.

If a business understands who its customers are (age, income and attitudes) and how they behave, it is in a good position to understand them well enough to keep them coming back. Occasional customers become regular, loyal ones, and others start to hear good things and try the product or service for the first time. Sales rise and, so long as costs can be kept from rising too much, profits can be boosted.

In a competitive market, the success of one company can spell trouble for another. Ultimately, all managers want success, whether in the Premier League or in the business world. Understanding customer needs is the starting point – to be followed by adjusting the business to meet those needs better. Many a corner shop is cramped, untidy and unwelcoming; the owner may moan about Tesco and Sainsbury's nearby but they seem unable to make the adjustments necessary to stay in business.

Talking point

'Why do shops die?' (James Marcousé, aged three years, two months)

Revision essentials

Choice: giving customers options and increasing the chance that the product will be perfect for the tastes/habits of one type of customer.

Convenience: making life easier for customers, perhaps by a great location (next to the bus stop) or a product that saves time in preparation or consumption.

Identifying customers: finding out who they are: their age, gender, incomes, where they live and what they want.

Quality: to a customer, quality means getting what they want, or perhaps better than expected; some companies use the term 'customer delight'.

Understanding customers: learning why customers do what they do, making it easier to see how to make a product that better suits them.

End of chapter exercises

1 **(a)** From the data in Figure 8.1 on page 40, calculate which of the supermarkets lost the most market share points between 2010 and 2021.

(b) Identify one other supermarket chain that performed particularly poorly. Explain why you chose that one.

2 Look at Table 8.1 on page 42 then suggest the keys to meeting customers' needs for a supplier of:

(a) baby car seats **(b)** lipstick.

3 Name two types of customer who might not 'value design and style above price'.

4 Explain the message being communicated by the quote from the Dell Computers advertisement on page 42.

5 Explain how Covid-19 lockdowns may have changed customer needs when shopping for groceries.

6 **(a)** Explain the difference between efficient and reliable.

(b) Explain which quality might be the more important for customers of a pizza delivery business.

Practice questions

Big Blue Surf School

Big Blue has received very favourable reviews on Tripadvisor

Big Blue Surf School is based in Bude, North Cornwall, and has been teaching people to surf for over 20 years. If you are looking to learn or improve your surfing or for a great family day out, then Bude is the place to go. We have safely and successfully introduced over 35,000 men, women and children to our wonderful sport, with many returning to us year after year. We run surfing lessons for individuals, families, schools and for those with autism and disabilities.

We operate on Summerleaze Beach, which is one of the most diverse surf destinations in Cornwall, with access to a sheltered bay when the conditions are big and an open sandy beach from mid to low tide, meaning we can accommodate all abilities in a variety of surf conditions. So don't worry if you're not a fan of big waves!

Summerleaze has gained its reputation as a highlight of the Cornish coast due to its many attributes, such as its renowned point-break surf during the high tide, a popular tidal pool, beautiful coastal paths and its position located in the heart of Bude.

Our coaches are fully qualified for all ability levels and are trained surf lifeguards. Most have grown up learning to surf in Bude, meaning they have a huge amount of experience with the area. We maintain a high coach-to-student ratio because when learning to surf, safety is our main priority.

Here at Big Blue we believe everyone should be able to join in, which is why we have been running specialised adaptive lessons for people with disabilities, neurodiversity, and those with mental health conditions. For more information visit our page: www.bigbluesurfschool.co.uk

We are also open all year round and have extra-thick wetsuits to keep you warm in the cooler months!

Out of 215 reviews on Tripadvisor, 210 rated the Big Blue experience as excellent. One reviewer from July 2021 said: 'Today my 16-year-old daughter and her friend had their first ever surf lesson and they loved it. They had never been on a board before and the guys at Big Blue had them up on a board a lot before the lesson was out. The guys were pleasant and polite, very knowledgeable and helpful. The lessons are great value for money. Thank you to all the staff there. So friendly and welcoming. You all made the girls' day. Will definitely book again.'

Total: 20 marks

1 **(a)** Outline one indication that Big Blue understands its customers. (2)

(b) Outline one way the business may benefit from this understanding. (2)

2 **(a)** Calculate the percentage of customers who rated Big Blue as 'excellent'. (2)

(b) Explain how a business might reward its staff for achieving such high approval ratings from customers. (3)

3 Outline one way Big Blue seems to be doing more than just making a profit. (2)

4 The Big Blue Surf School is considering expanding. The managers see two options:

- Option 1: Open a second school in the North East, close to Newcastle.
- Option 2: Offer cheaper rates to school groups, to attract extra summer business.

Justify which **one** of these options it should choose. (9)

9 Market research

The purpose of market research

There are four main areas where market research can prove itself value for the money it costs to carry out:

1. To identify and understand customer needs.
2. To identify gaps in the market.
3. To reduce risk.
4. To inform business decisions.

To identify and understand customer needs

The importance of understanding customer needs was covered fully in Chapter 8. While small service businesses are often in touch with customers daily, bigger firms – especially manufacturers – may never deal directly with shoppers, which makes market research essential.

To identify gaps in the market

As will be shown in Chapter 10, market research has an important part to play in 'mapping' the market. It shows which customer requirements are covered, and which are not. When gaps are uncovered it makes sense to act quickly before competitors move in. At the time of writing, Nestlé has launched a vegan KitKat. It believes that growing sales of plant-based foods such as vegan burgers have created a gap for vegan chocolate products.

To reduce risk

There are two fundamental risks in launching a new product:

- that the market may not want the new product
- that demand may exist, but not enough for the new product to be worth all the costs of development and launching.

Quantitative research (see below) should be able to warn against either possibility.

To inform business decisions

In other words, to provide information to help managers make better decisions. Even in quite small businesses a wrong decision may cost a big sum of money. In June 2021, Hotel Chocolat made headlines for paying just £4 to buy the beauty brand Rabot 1745. The brand was already part-owned by Hotel Chocolat and produced cosmetics using chocolate-based ingredients. Although the purchase price was less than a box of chocolates, the deal also meant paying off the Rabot chairman's £744,000 loan to the business. So the Hotel Chocolat bosses had to be sure of their decision. To test it, they opened a huge Hotel Chocolat outlet in Japan, dedicating a large section to beauty products. 'Very encouraging' sales gave the green light to the Rabot decision.

> Advertising people who ignore research are as dangerous as generals who ignore decodes of enemy signals.
>
> *David Ogilvy, advertising executive and author of Ogilvy on Advertising*

Methods of market research

Secondary research

Many people starting their first business have a clear idea of the opportunity. They may be sure that 'everyone loves biscuits'. This makes it important to check the facts. The starting point is **secondary research**: this means finding out data that already exists, that is, second-hand information. Figure 9.1 shows publicly available data showing the market breakdown between sweet biscuits, crispbreads and cereal bars. Some secondary data is available free, by careful use of the internet or by buying a 'trade' magazine such as *The Grocer*.

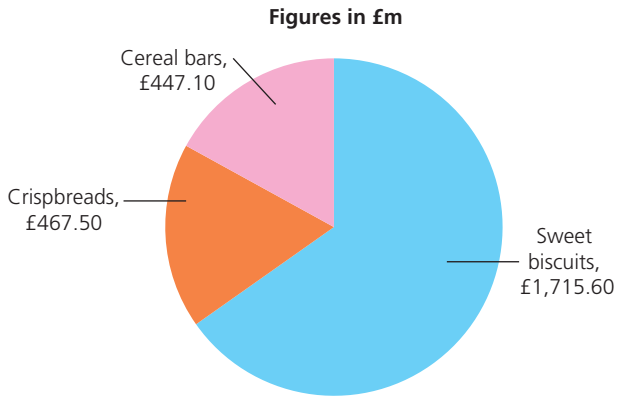


Figure 9.1 UK biscuit market breakdown (Source: *The Grocer*, 19 December 2020)

On 19 December 2020, *The Grocer* magazine provided this secondary information about the UK biscuit market:

- Sales of Oreo biscuits rose 10.6 per cent in 2020 to £54.3 million. McVitie's Chocolate Digestives also did well, implying perhaps a growing trend in chocolate biscuits.
- McVitie's was the most powerful biscuit brand, with a 2020 market share of 26.5 per cent and a much faster sales growth rate than the market as a whole. For a new business starting up in this market, it is best to avoid competition with McVitie's products.

Government reports are a useful (and free) source of secondary data. For instance, if you're thinking of opening a milkshake business, it is a great help to find out that the number of 15- to 19-year-olds is forecast to rise from 3.9 million in 2022 to over 4.3 million by 2027.

Primary research

Having learned about the market background, it is time to consider **primary research**. This is first-hand research in which you find out the precise things you want to know from the people you need to talk to. When starting a business, the people you might want to talk to include:

- existing customers (currently buying from companies that will soon be your competitors)
- potential customers (those you might be able to persuade to buy for the first time)
- potential retailers (the shops that you hope will stock and sell your product).

The value of primary research is that it can tell you exactly what you need to know about your business. The problem, though, is that it is time-consuming and expensive to collect the data. For example, to find out whether your biscuits should be priced at £1.49 or £1.99 might require interviewing more than 100 people. That takes time.

In primary market research, customers are asked directly for their opinions

Table 9.1 The main methods of primary market research

	Explanation	Advantage	Disadvantage
Online survey	Online surveys are a cheap, useful way to get a limited amount of feedback	Can be used regularly, e.g. monthly, to check on customer satisfaction	Online surveys will overwhelmingly be answered by those with time on their hands – probably older people
Questionnaire	A business could carry out a questionnaire to assess potential demand for a product/service	A firm can identify its target customers (age, job, etc.) – this can help with promotion and also establish the likely selling price and sales level	Can be very time consuming – taking time to carry out questionnaires is expensive and may not be helpful Questions can be biased, giving misleading results
Focus group	This allows for more in-depth answers than a questionnaire, as well as more open questions	Interviews give firms an insight into customer perceptions and behaviour; this can help a firm decide on branding and advertising images	Time consuming and expensive The interviewer can sometimes affect the results, e.g. some interviewees may be too embarrassed to admit how much they really spend on chocolate
Observation	Watching where customers go and how long they spend in different parts of a shop	Can show where people are interested but still don't buy – is the layout too confusing?	Time consuming and expensive

Qualitative and quantitative research

Primary research can be collected in two forms: qualitative and quantitative.

Qualitative research is in-depth research into people's opinions and views, and is usually carried out among a relatively small group of people. It can provide insights that help a business to make decisions. For example, a group of eight people might be asked to discuss their pizza takeaway likes and dislikes. It might become clear that the most common complaint is not knowing exactly when it will arrive – in which case this can become a major part of a new firm's advertising message: 'We'll deliver on time, every time'.

Quantitative research means collecting lots of answers to specific questions. Usually these questions are 'closed', meaning that the answers are limited to ticking a box such as 'yes' or 'no', or 'will definitely buy' or 'will probably buy', and so on. This type of research provides factual information, such as that 20 per cent of people like pineapple on pizza, but 80 per cent do not. Quantitative research is usually gathered by interviewers using questionnaires, either in person or over the phone. Questionnaires can also be completed without an interviewer, for example online or by post.

Social media feedback has become an important alternative to formal market research. Some quantitative evidence is publicly available, for example that 51.2 per cent of 11,400 Center Parcs visitors to its Whinfell Forest site rated the experience as excellent. But of 8,400 visitors to the newer Woburn Forest site, only 42.4 per cent rated it excellent. That information from Tripadvisor is useful to holidaymakers, but also to the company. It should consider how to make the Woburn Forest site more enjoyable.

> The trouble with research is that it tells you what people were thinking about yesterday, not tomorrow. It's like driving using a rear-view mirror.
>
> *Bernard Loomis, US toy developer*

The use of data in market research

Research takes time and money to collect. The key to success, though, is to interpret its findings. With quantitative (yes/no) research, it should be easy. There may be problems, in being sure that the figures mean what they say, however. For instance, 100 people may say they prefer a thin base to their pizza, but can you be sure that the same is true of *all* pizza lovers? You can only be sure of the findings if you are confident that the people who responded are typical of everyone. If a young Bolton businesswoman asked 100 friends to fill in a questionnaire, the results might only be meaningful for young people in Bolton, not the whole market. Needless to say, market research data has to be reliable to be worthwhile.

Questionnaires are a useful way to collect information

Qualitative research is even harder to interpret. If three or four people in a group discussion feel strongly about something, so what? For example, a few people may say that they hate herbs on pizza. Should that be taken seriously?

Therefore, market research findings are important and interesting, but need not always be taken seriously. A confident businessperson may be right to ignore some research findings, perhaps choosing to build a business that's a bit different and may not appeal to everyone's tastes.

Talking point

Pizza Hut has gone from being the leading pizza takeaway business to trailing after Domino's. How might Pizza Hut use market research to reboot itself?

Revision essentials

Focus group: a group discussion among people selected from the target market; it draws on psychology to provide qualitative insights into consumer attitudes.

Primary research: research conducted first-hand; it is tailored to a company's specific needs, for example a quantitative sales estimate for a brand new chocolate bar.

Qualitative data: in-depth research into the opinions and views of a small group of potential or actual customers; it can provide insight into why consumers buy what they buy.

Quantitative data: factual research among a large enough sample of people to provide statistically reliable results, for example a survey of 500 people aged 15–24 years.

Secondary research: when a company uses research that has already been carried out for general purposes.

End of chapter exercises

1 Use the information in Figure 9.1 on page 46 to calculate what percentage sweet biscuits have of the whole UK biscuit market.

2 Outline one way that Center Parcs might use primary research to find out why a higher percentage of customers rate Whinfell Forest as excellent than Woburn Forest.

3 Explain why market research through social media may prove relatively unreliable.

4 Give two reasons why a young entrepreneur might use secondary rather than primary research to help decide whether or not to open a vegan takeaway.

5 Read the following extract and answer questions (a) and (b).

In autumn 2021, Ferrero launched a range of three Ferrero Rocher chocolate bars into the UK market. The Italian company had spent three years developing the products and the packaging. It employed 50 people to test more than 300 recipe combinations before deciding on the final three. It used quantitative and qualitative research as part of its development programme. Focus groups drew attention to 'big night-in occasions' as an opportunity for getting chocolate lovers to 'trade-up to something special'. The three bars (milk, dark and white chocolate) all have the Rocher connection with hazelnuts. The price of £2 per 90 g bar is significantly above standard Cadbury's Dairy Milk.

(a) Explain how the use of quantitative research might have helped the Ferrero Rocher team develop the product recipes.

(b) Explain why qualitative research might be best for developing the idea of 'big night-in occasions'.

6 Dave's Drinks must analyse the research into two new fruit drinks shown in the graph below to decide which new product to launch. Experience has shown that strong commitment by interviewees is important.

Which two of the following are correct statements?

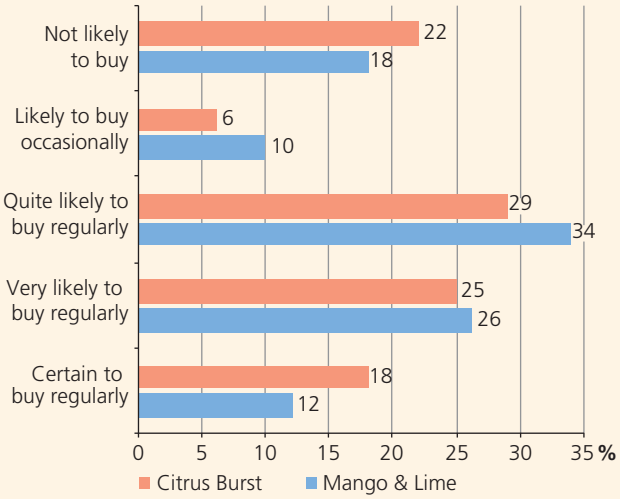
(a) People are more likely not to buy Mango & Lime than Citrus Burst.

(b) More people considered buying Mango & Lime regularly than they did Citrus Burst.

(c) Citrus Burst looks the better option based on the figures.

(d) 72 per cent of interviewees considered buying Mango & Lime regularly.

(e) Decisions on launching new products would be better made on the basis of qualitative research.



Results from quantitative research into two new real fruit drinks

Practice questions

ASOS takes on Marks & Spencer

In recent years traditional clothes retailer Marks & Spencer (M&S) has suffered declining sales; by contrast, online shop ASOS has enjoyed rapid yearly growth. Many people believed the M&S problem was its failure to attract shoppers under the age of 40.

The company announced proudly that it would use its next shareholders' meeting to research the styling and colours for its cardigans; a business newspaper pointed out that this would mean a focus group among its 70-year-old shareholders. Meanwhile, ASOS was using social media both for research and publicity. It organised groups of ASOS customers of different ages to give instant feedback on new clothes designs and encouraged shoppers to upload photos of themselves wearing new items – #AsSeenOnMe – and then monitored comments on the styles and colours.

The value of ASOS' modern approach to market research showed in its share price. In the two years to August 2021 its shares were up 65 per cent; M&S shares were down by 24 per cent.

Total: 18 marks

1 Define 'focus group'. (1)

2 Outline one possible impact on M&S of its focus groups with shareholders. (2)

3 Analyse the impact on ASOS of its approach to market research using social media. (6)

4 M&S must find out how to appeal to clothes buyers under the age of 40. Financial restrictions mean it must choose between:

- Option 1: Qualitative research.
- Option 2: Quantitative research.

Justify which **one** of these options the company should choose. (9)

Practice questions

Cudoni

Do you want a second-hand bag? Just £4,000.

Or second-hand trainers for £300? Possibly not, but Cudoni hopes you'll buy because it charges a 40 per cent fee on all sales. So, that £4,000 Chanel bag means £1600 for Cudoni.

Cudoni was started by 25-year-old James Tyrer and two friends. James saw an opportunity for an online reseller of luxury goods. Before starting the business he did a lot of market research. A focus group among potential customers revealed how much they cared about the condition and presentation of the items. If they spent £4,000 on a bag, it must be hand-delivered and presented personally to the customer.

James used that idea to create a unique selling point for his online business. Today, even though many other businesses sell 'pre-loved' luxury items online, Cudoni stands out because of its exceptional customer service.

Certainly Cudoni is enjoying success. It began in 2017 with £150,000 of start-up capital from James, his friends and some outside investors. By the end of September 2018 it had £320,000 cash in its bank account. A year later there was more than £1 million, and in September 2020 the cash total reached £3 million.

James is even thinking of a new Cudoni online shop focused only on nearly-new Nike trainers, which can sell for amazing sums, especially if celebrity-owned.

Total: 20 marks

1 Outline one factor that may have affected the reliability of James' research findings. (2)

2 Explain why it is important for a business to understand its customers. (3)

3 Analyse how well James used market research in establishing Cudoni. (6)

4 Before going ahead with the new Nike business, James is considering two options for further research:

- Option 1: A quantitative study using questionnaires.
- Option 2: Qualitative research using both face-to-face conversations and conversations via social media.

Justify which **one** of these two options James should adopt. (9)

10 Market segmentation

Market segmentation means dividing customers within a market into smaller groups with common needs or wants, then finding a product or service that fulfils those needs or wants. When Covid-19 lockdowns hit in 2020, UK households spent £50 million extra on biscuits. Burton's Biscuits stepped up its marketing for Wagon Wheels, judging that they would sell more strongly to parents/adults. The brand was rewarded with an 18 per cent sales increase.

No one wants to buy 'a book'. They want a book that fits their taste, their personality and their current mindset (romantic, perhaps). Careful market segmentation allows businesses to target like-minded people. A blockbusting bestseller only has to sell to 1 million people, which is just two per cent of the population. Segmentation helps companies (and authors) to focus on just one type of customer.

There are many ways in which customers within a market can be divided up (segmented), including:

- **location** (where people live)
- income
- **lifestyle**
- age
- other **demographic** factors.

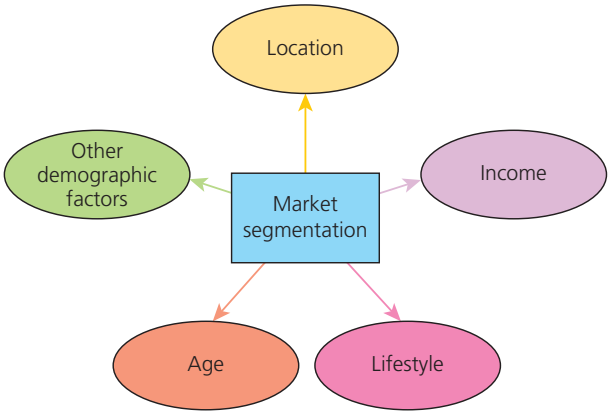


Figure 10.1 Ways in which a market may be segmented

Location

There are some clear, common factors shared by people living in certain areas within the UK; even when people move to a different region or country, they may still feel like a 'scouser' or a 'cockney', for example. This common identification with a specific area can give rise to business opportunities. The British may all like the same milk chocolate, but for some it must be Yorkshire tea, Cornish pasties and Welsh teacakes.

Regional changes in taste make it possible to find gaps in the market that cannot easily be filled by large companies. Nestlé owns Rachel's Organic and would have little interest in a yoghurt targeted just at the Scots (8 per cent of the UK population) or at the Welsh (4.8 per cent). But a small, local business could make a very good living in a market still measured in millions of people.

So, segmentation by location can make good business sense.

> Firms have moved from mass marketing to segmented marketing, in which they target carefully chosen submarkets or even individual consumers.
>
> *Philip Kotler, marketing guru*

Income

Income is one of the most obvious forms of segmentation. As shown in Table 10.1, it is very obvious in the market for hotel rooms. All of the hotel brands listed belong to the French hotel chain Accor; in essence, however much money you've got, the hotel group will be happy to take it.

Table 10.1 Same hotel group, different prices (prices as of May 2021)

Hotel brand	Brief description	Price per night (London, room only)
The Savoy	'Quintessentially British'	£664
Sofitel	'Life is Magnifique'	£343
Pullman	'Your business trip at Pullman'	£205
Novotel	'Your midscale hotel experience'	£199
Ibis, London City	'Comfort at the best price'	£115
F1, Porte de Montreuil, Paris (no F1 in London)	'The low-cost brand'	£30

In many other markets income is a key form of segmentation. A £300,000 Rolls-Royce and a £10,000 Kia are both in the car market, but are they in competition? Clearly not. Rolls-Royce is in a super-luxury segment defined more by price than anything else – and, therefore, by income.

> Segment or die.
>
> *Philip Kotler, marketing guru*

Lifestyle

Whether rich or poor, young or old, people are simply different. In the grocery and catering trades, vegetarians matter. The NHS says there are 1.2 million vegetarians in the UK, though other estimates are as high as 3.1 million. Other lifestyle choices include our hobbies and sports. Figure 10.2 shows weekly participation in sport among adults aged over 16. Boxers represent a small minority, but there are still opportunities for small entrepreneurs.

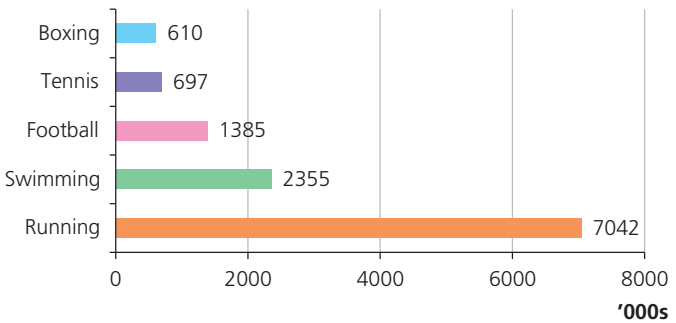


Figure 10.2 Lifestyle markets (adults, England only): runners are a big opportunity (Source: Statista 2019/20)

In less physical sport, computer games are another lifestyle choice. It may well be that this segment – which is largely male, aged 14–18, playing PS5 and/or Nintendo Switch – has common characteristics of interest to businesses (perhaps a higher preference for Domino's pizza than the general population).

Talking point

Statistics show that 14- to 18-year-old boys spend an average of eight hours a week playing computer games. What business opportunities might this give rise to?

Age

Age is a huge factor in market segmentation. Not only are there products targeted solely at certain age groups, from soft toys to stairlifts, there are also types of product that can be tailored to a specific age group. In national newspapers, the *Daily Express* targets over-60s; in yoghurt, Munch Bunch and Petits Filous are targeted at the under-10s.

One of the reasons businesses like to segment markets is because they find they can charge higher prices for carefully tailored products. Homes for the elderly can command a 30 per cent price premium, which might easily mean an extra £100,000 for the developer. These purpose-built estates will have easy access to every home, nursing on site and perhaps a golf course or swimming pool on site. In the USA, 17 per cent of homes are designed for the elderly. In the UK, the figure is just 2.5 per cent but rising sharply.

Markets can be segmented by age

Other demographic factors

Demographics are the characteristics of a population. Age is important, but it can usefully be broken down further: young adults with kids, young single adults; young adults at university, and so on. Each group will have its own patterns of spending. Further potential areas for demographic segmentation include:

- gender (an important factor in markets such as books, toiletries, clothes, magazines and much, much more)
- race (an important factor in markets such as cosmetics, music and eating out)
- religion (an important factor in markets such as food, clothes and toys).

Drawing the right conclusions

Segmentation is the essence of a modern economy. It leads to an extraordinary amount of consumer choice, in which there's usually something that suits or fits. The better a product meets our needs, the more we're willing to pay for it. This enables businesses to make the extra profit needed to pay for all that product development.

To segment means no more than to understand your customers well enough to categorise them – and then develop a product that wows them.

Revision essentials

Demographics: the study of the statistical differences that exist within a population, both now and in the future.

Lifestyle: grouping people by common characteristics in how they live, from their participation in sports and leisure to their views on the environment, taste in music and even nerdier things such as a passion for trains.

Location: the extent to which consumers identify with the place where they were born, or grew up.

Market segments: the subsets within a market that have been identified as a result of market segmentation.

End of chapter exercises

1. How might a small, Yorkshire-based bakery use segmentation to help boost profits?
2. Look at Figure 10.2 on page 52. There are 35.5 million adults aged 16–64 in England. What percentage are regular boxers?
3. Look at Table 10.1 on page 52, which shows the prices charged by the Accor hotel chain. Explain how it is possible for customers at Sofitel and Ibis to both consider that their room for the night was value for money.
4. Tesla has ambitions to be the world's biggest car producer. How might market segmentation help it achieve this goal?

5 Assume you get involved in opening an online music store. How might you choose to structure the website's home page based on market segmentation?

6 Read the following extract and answer questions (a)-(c).

With UK sales of £399 million and £286 million, respectively, energy drink sellers Red Bull and Monster both had a good 2020. However, 62 per cent of UK consumers do not drink energy drinks due to disliking the ingredients and taste. Since its UK launch in 2016, the Thai energy drink Carabao has pushed to get a meaningful share of the huge UK thirst for energy drinks.

In 2020, the company launched Carabao Mixed Berry. But perhaps its marketing is wrong, stressing that 'it tastes like a soft drink and has just 63 calories'. Perhaps energy drinks are supposed to seem a bit dangerous.

(a) Outline an age group that might welcome Carabao Mixed Berry.

(b) What business problem might arise if a segment such as the one targeted by Carabao Mixed Berry proves to be too small?

(c) Calculate Carabao's sales if it can achieve two per cent of the combined sales of Red Bull and Monster.

Practice questions

Changes in home ownership

A recent House of Commons report found that real incomes for 22- to 29-year-olds declined by 4 per cent between 2008 and 2020. The report explained that plenty of young adults have found work but the wage rates have been disappointingly weak. That, in turn, has forced more to stay living at home.

A different source of data showed the effect of this on home ownership among young adults.

For James Turner Ltd, a small Coventry building business focusing on bathrooms, the implications were clear: older people are the target segment, and traditional styles of bathroom are the likely way to appeal to them.

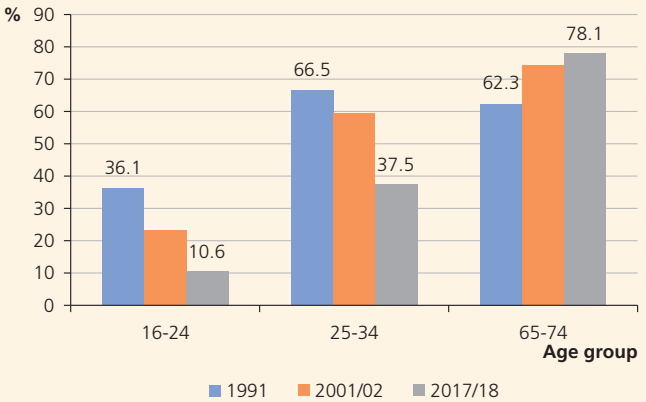


Figure 10.3 Percentage of people owning their home, 1991–2018 (Source: ONS)

Total: 15 marks

1 **(a)** Calculate the percentage change in home ownership within the 16–24 age group between 1991 and 2018. (2)

(b) Outline one possible reason why this change occurred. (2)

2 Outline one possible market that may benefit from rising incomes among older people. (2)

3 James Turner Ltd must decide how best to appeal to the over-65s age group. Financial restrictions mean it must choose between these options:

- Option 1: Television advertising.
- Option 2: Advertising in the local Coventry newspaper.

Justify which **one** of these options the company should choose. (9)

11 Market mapping

Years ago, the secret to business success was price **competition**: spot a successful business, copy its idea and offer the same thing, but cheaper. Pepsi did this with Coke; Branston did it with Heinz Beans; and supermarkets do it all the time with own-label versions of new products.

To a certain extent it still happens, but within a careful attempt at mapping the market. This means setting out the key features of the market on a diagram, then plotting where each brand fits in. For example, key features of the chocolate market include:

- luxury versus everyday eating (for example, Lindor versus Dairy Milk)
- filling versus light (for example, Snickers versus Maltesers).

A **market map** based on this idea would look like Figure 11.1.

Figure 11.1 Chocolate market map (author's estimate)

A business such as Cadbury would spend a substantial sum each year (perhaps £100,000) gaining the market research evidence to get this market map right. It would usually be based on the opinions of thousands of customers. Armed with this information a decision could be taken, such as to work on a new product that has a luxury feel *as well* as being filling. In other words, to fill the market gap in the top left of the map. In the recent past, Cadbury has tried a praline chocolate bar to fill this **gap in the market**, but no one has launched a successful new brand.

The idea of market mapping is to identify gaps, to show where a sector is overcrowded, and to stop a producer becoming over-reliant on one sector. Mars is very strong in the filling, everyday sector (Twix, Mars and Snickers), but this is a declining sector as people worry more about their health. Fortunately, Mars also owns the Maltesers brand.

The everyday sector of the chocolate market is declining as people worry more about their health

For most businesses, the difficulty is in identifying the key factors to use in the mapping exercise. These might include:

- high-priced/low-priced
- for the young/for the old
- modern/traditional
- for men/for women.

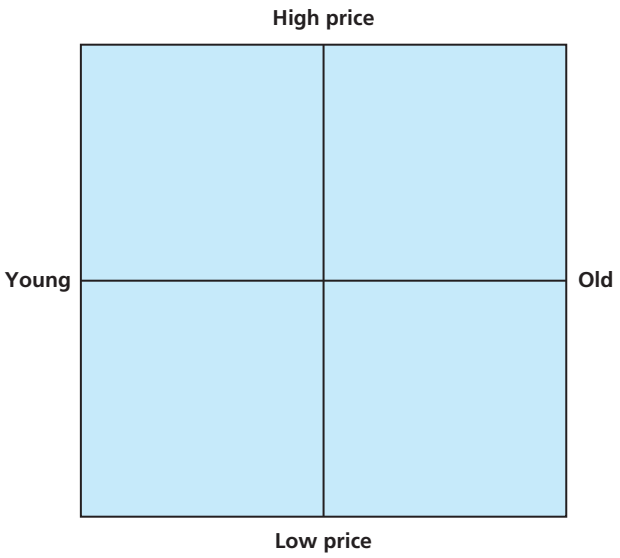
Companies decide on the 'right' factors after careful market research. Talking to customers may show that young and old have similar views about chocolate, whereas men and women think differently.

Market mapping is also very useful for a new small business, for example in building services. Internet research may show that there are lots of emergency plumbers but few offering to fit luxury bathroom suites.

Talking point

Where do these fit on the market map?

- Nintendo Switch (in the games console market)
- Tesla (in the car market)



Of course, there remains a potential problem. Perhaps there is a gap because there is no effective demand locally, in which case further market research may need to be carried out. The fact that market mapping is not a magic solution should not stop it being used. All business decisions require thought; no single method provides guaranteed success.

> The aim of marketing is to know and understand the customer so well the product or service fits him and sells itself.
>
> *Peter Drucker, business guru*

Drawing the right conclusions

In the TV series *Dragons' Den* people often talk about a 'gap in the market'. Market mapping is a perfect way to identify a gap. An entrepreneur can then investigate the product or service that will meet customer needs within that gap. This was how companies found multi-million pound opportunities with products such as gluten-free bread and dairy-free yoghurt.

Revision essentials

Competition: companies operating in your market or market sector.

Gap in the market: an area on a market map where few or no existing brands operate, implying a business opportunity to fill an unmet consumer need.

Market map: measuring where existing brands sit on a two-factor grid, for example young/old compared with high price/low price.

End of chapter exercises

1 Suggest two reasons why it may no longer be enough to produce cheaper copies of product ideas.

2 Suggest where Lindor might appear in Figure 11.1 on page 55, the chocolate market map. Explain your reasoning.

3 **(a)** Look carefully at Figure 11.1. Identify two possible opportunities for a new company entering the market.

(b) For one of those opportunities, outline a product that you think might appeal to consumers. Suggest a price that you think would be appropriate.

4 Read the following extract and answer question (a).

For a recent class project, Aliesha drew up a market map of her local area (Brixton, South London). She identified that there were many takeaways and cafes offering Caribbean food, but nowhere offering a smarter restaurant for special occasions. Her market research showed that 32 per cent of adults locally thought they would go to a smart Caribbean restaurant at least once a year. Aliesha was able to show that this business could be very profitable.

(a) Outline one way in which Aliesha might have carried out her market research.

5 Construct a market map for takeaways and fast-food outlets in your local area. Use the following scales:

(i) expensive–cheap

(ii) for young people–for older people.

6 Read the following extract and answer questions (a) and (b).

On 14 August 2021, Russian discount giant Mere opened its first store in Preston, Lancashire. It plans to open three more by the end of 2021, and 300 by the end of the decade. Mere will offer shoppers a restricted range of 1,200 products – a far cry from the 20,000 available at a large supermarket. Prices are claimed to be 30 per cent lower than Aldi and Lidl (which are already 15–20 per cent cheaper than most supermarkets). The Russian owners believe that Aldi and Lidl have strayed too far away from their original low-cost plans. Mere will offer no shop floor service; suppliers will deliver directly to pallets on the floor (so no time 'wasted' stacking shelves) and store locations will be in low-rent parts of towns. No money will be spent on advertising. Mere's managers believe that word of mouth and social media will spread the message about its ultra-low prices.

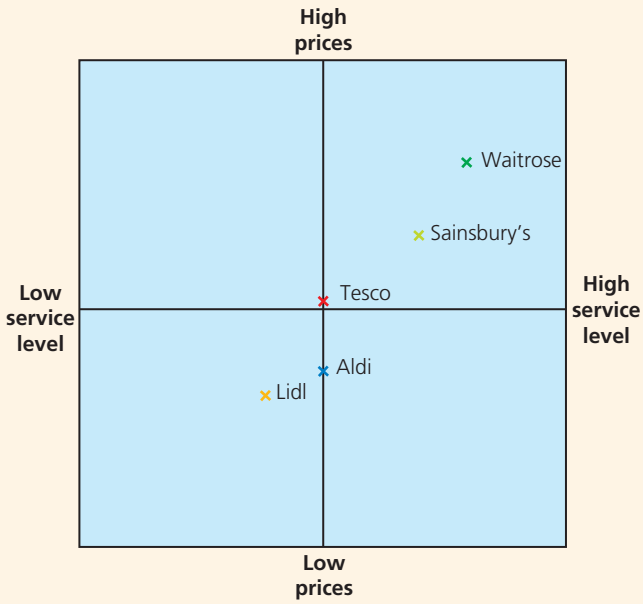


Figure 11.2 Supermarkets market map

(a) Based on the text, where would you place Mere on the market map in Figure 11.2? You could re-draw the map or describe carefully where Mere would appear.

(b) Do you think there's a big enough market gap to allow Mere to be a success in the UK?

Practice questions

The billion pound opportunity

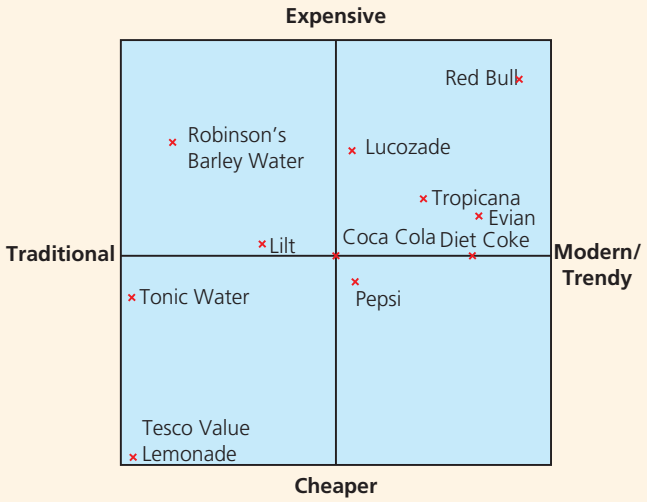


Figure 11.3 Soft drinks market map

In years gone by the soft drinks market was dominated by fizz, with Coca-Cola as the leading brand. With UK sales of over £1.4 billion a year, Coke is still massive, but in 2019 and 2020 it lost share in the cola market to Pepsi. In recent years other big winners have been:

- energy drinks, such as Red Bull and Monster
- adult-focused drinks, such as Fever-Tree and Fentimans
- drinks with a healthy 'vibe', such as Innocent Coconut Water (£2.49 for 500ml).

Oddly, though, in the UK no one has quite managed the trick pulled off by Oasis in America – a big-selling, non-fizzy drink for adults.

Total: 15 marks

1 Outline one possible reason why Coca-Cola is losing out to Pepsi. (2)

2 **(a)** Outline where you think coconut water is positioned on the soft drinks market map. (2)

(b) Outline one benefit of that positioning for a business such as Innocent Drinks. (2)

3 Innocent Drinks has ten per cent of the market for coconut water. To build on this, the managers see two options:

- Option 1: Focus on coconut water to build up market share at the expense of rivals.
- Option 2: Launch other plant-based waters, such as cactus juice and maple water.

Justify which **one** of these options the managers should choose. (9)

12 The competitive environment

When you moved into a new house in the 1980s, you did not phone everyone to tell them. You did not have a phone. You applied to British Telecom (BT) to get a line for a phone. It took between one and three months. Within five years, that position was transformed. For the first time, the government allowed competitors to enter the market for phones. BT quickly responded by speeding up their services and increasing choice. The arrival of competition improved things for the customer.

Competition is often the biggest headache for a new, small business. The business may identify a profitable market gap, but what if another firm arrives at the same time as you? Instead of being the only Thai restaurant in the village, there may be two – both half empty. Even if you get there first, your success may simply attract copycats.

This is why starting a business requires self-confidence and a willingness to take risks. Competitors may arrive, making it very difficult, but they may not. In 2006, Trunki was turned down in the *Dragons' Den* because it would be too easy to copy. But by 2019 exports were booming (especially to Europe), bringing sales to £10 million and profits to £777,000. Inventor/owner Rob Law says that he has had to spend more than £1 million preventing copycat products coming on to the market. This has helped keep the business profitable. Neither Brexit nor Covid-19 was good for the business, but apparently one-fifth of all 3- to 6-year-olds in the UK has a Trunki, so the future looks secure.

> Competition generates energy, rewards winners and punishes losers. It is therefore the fuel for the economy.
>
> *Charles Handy, Irish business guru*

Trunki inventor/owner Rob Law has spent more than £1m preventing copycats from coming on to the market

Strengths and weaknesses of competitors

To analyse the strengths and weaknesses of your rivals, a good starting point is to talk and, especially, listen. Get focus groups of customers talking about how, when and why they use the rival product or service. What was their experience before and after buying, and would they buy the same thing again? If not, why not? Before Sammi Garnett started up an Italian restaurant in Northampton, she and her boyfriend simply asked around at pubs in the town for views of the existing places to eat. She learnt that nowhere offered a good deal for office parties of eight or more people, and chose to make that a feature of her restaurant. It proved very successful, providing 25 per cent of all her business.

> Competition brings out the best in products and the worst in people.
>
> *David Sarnoff, former president, RCA*

The features of your competition that you should focus on include the following:

1. Price: what do they charge and for what? The prices at a sandwich shop may seem quite high but, if there's free delivery to the local area, it may seem good value to busy (or lazy) office workers. In general, people starting a new business focus too much on low prices. If the new business has found a real gap in the market, it shouldn't need to risk looking 'cheap'.
2. Quality: for businesses today, quality is a must rather than a special feature. If the delivered pizza is not hot or looks tired, that's a lost customer. For a new pizza business, nothing could be more worthwhile than ordering pizzas from all the competitors. Those that are slightly second-rate can be targeted, because they are vulnerable to being put out of business.
3. Location: it is a business cliché covering hotels, restaurants and much else, that the three most important factors in success are location, location, location. A rival may have a good business with supportive regulars, yet still be pushed off course by a newcomer with a better location. Of course, the better the location, the higher the rent, so a new business must make sure to balance out the benefits from higher customer numbers against the downside of higher fixed property costs.

Talking point

You're thinking of opening a fashion shoe shop next to a big Asda supermarket. What analysis should you carry out on your big competitor?

4. Product range: in 2021, Sony's PS5 was enjoying sales growth, yet struggling to get close to the sales of the Nintendo Switch. A major reason was that it was being outsold 4 to 1 in Sony's home country, Japan. The Japanese preferred Switch because they wanted a hand-held console to play on the move; Westerners tend to play at home. Years before, Sony had a huge-selling portable console (the PSP) but now there was a gap in the product range. PS5 was doing well, but with a portable version as well it might become the world number one.
5. Customer service: customers expect efficiency (right pizza, right size), speed (in 20 minutes, as promised) and politeness, even a smile. In many products and services, after-sales service is every bit as important; for example, when a PS5 player has problems with sound, is it easy to get the problem sorted? If a rival is weak at customer service, it is an open goal for your new business to score in.

Careful analysis of the local competition is a must for a new business. If all the rivals are really strong, you may decide not to start up at all. Unless you

know how you can be better, you should not risk your money. Usually, though, businesses are far from perfect. The small grocer may be cramped and unfriendly. The cinema may only have one screen and be uncomfortable. If you can build your strength on your competitor's weakness, the result should be successful.

One pizza delivery firm's 'buy one get one free' offer is quickly matched by rivals

Impact of competition on the business

Competition forces businesses to be at their best – always. Competition forces firms to:

- offer good products and a good service
- keep prices down
- bring in new, **innovative** products or services to break away from fierce price competition.

These consumer benefits place firms under constant pressure. A bright new idea will soon be copied by rivals. A profitable service may be undermined by price cutting. This is clearly the case in businesses such as pizza delivery, where one firm's 'buy one get one free' offer is quickly matched by rivals.

Competition can also force businesses to do things that they would prefer to avoid. With high rents, city centre bars have to get good trade on Fridays and Saturdays. If your rivals have special deals or 'eat as much as you like for £10' offers, you must join in or close down. Similarly, if other banks have relocated their customer call centres to India, you may feel that you have to cut your own bank's costs by following them.

Fierce competition may force firms to:

- cut costs by cutting staff – bad for the staff and perhaps bad for customers
- take short-term action, such as price cutting, which may damage the long-term health of the business
- adopt **unethical** practices, such as dumping waste materials or injecting water into meat (bacon often has 15 per cent extra water pumped into it, to plump up the meat and make it easier to charge a price that customers think is good value for money).

> I feel sorry for those who live without competition ... fat, dumb, and unhappy in cradle-to-grave security.
>
> *Donald M Kendall, businessman and political advisor*

Revision essentials

Competitive environment: the strength of competition between companies in the same market.

Innovative: a new, perhaps original, product or process.

Unethical: an action or decision that is wrong from a moral standpoint.

End of chapter exercises

1 From your own experience, analyse the strengths and weaknesses of two local fast-food businesses.

2 **(a)** Explain the possible effect on UK ice cream businesses if a big US chain chose to open 100 ice cream parlours in the UK.

(b) Outline two possible drawbacks to staff at existing ice cream shops if a fierce new competitor arrived.

3 **(a)** Why might it be unethical for a cafe to run an offer such as 'eat as much as you like for £10'?

(b) Why might competition force a cafe to run such an offer anyway?

4 Read the following extract and answer questions (a)-(c).

In autumn 2020, Smokin Bar & Grill Ltd was established as a new private company at Companies House. In March 2021, Blackburn Council announced a £3.8 million development to transform a nineteenth-century building to the north of the town. There would be a large terraced area outside and space for two restaurants. One would be Smokin Bar & Grill. It would benefit from £70,000 of the council's money being used to convert an old pub to new restaurant premises. The entrepreneur behind Smokin Bar & Grill is Zah Hussein, who will be hoping that the new development is completed within the planned 18 months. Only then can his investment (expected to be £150,000) start to pay off. And he will wonder about the competitor he will face from the second restaurant.

(a) Outline the evidence that Zah Hussein understands the role of an entrepreneur.

(b) Zah did some market research, but should he have found out more about his new competitor before investing in Smokin Bar & Grill?

(c) Outline one approach Zah could take to help his new restaurant become a long-term success.

5 Covid-19 lockdown closed clubs, bars and gyms, and could have damaged the sales of energy drinks. Table 12.1 shows shop sales in 2020. Do you think Red Bull or Monster did better in 2020? Explain why.

6 The American Waffle bar in Ipswich has a new competitor: Alabama Waffles. It is only 50 metres away and has a one-month opening offer of free coffee or hot chocolate with every waffle order. Which two factors are most likely to protect the American Waffle bar from this tougher competitive environment?

(a) The American Waffle bar's location.

(b) American Waffle's consistent focus on customer delight.

(c) That an American Waffle is 25p cheaper than an Alabama Waffle.

(d) The American Waffle bar has a special focus on customer demographics.

(e) The American Waffle bar has a special gadget for testing when the waffles are perfectly cooked.

Table 12.1 Sales of energy drinks in the UK (Source: *The Grocer*, 19 December 2020)

	2020 sales	Change in past 12 months	% change in past 12 months
Red Bull	£399.1m	+£23.3m	+6.2%
Monster	£286.3m	+£43.1m	+17.7%
Relentless	£42.0m	-£2.2m	-5%

Practice questions

Hot competition

When the Aston & Magill cafe opened along a busy main road in Merton Park, South London, it had no immediate competitors. Within 6 months, though, Waffle Jack's opened on the other side of the road to provide the first serious competition, followed shortly by Willow Tea Rooms. For Aston & Magill, it meant a difficult period, but within 12 months, the cafe was back 'in the black' (making an operating profit). Then came a real shock: 100 metres down the road, on the same side of the road, a 'Costa Opening Soon' sign appeared over large shop premises. Now the competition would really hot up.

Total: 15 marks

1 **(a)** Define the term 'competition'. (1)

(b) Outline one possible reason for Aston & Magill's 'difficult period'. (2)

2 State one benefit to Aston & Magill of its current location. (1)

3 Outline why the arrival of a Costa might be a bigger worry than the arrival of Waffle Jack's and Willow Tea Rooms. (2)

4 The owners of Aston & Magill must decide how best to cope with the arrival of a large Costa coffee shop. They see two main options:

- Option 1: Keep prices for their food and soft drinks unchanged, but be aggressive on the price of coffee, cutting it from £2.20 to £1.50 – far below the price at a Costa.
- Option 2: Offer existing customers a powerful loyalty card, giving a 25 per cent discount off all future purchases.

Justify which **one** of these options the company should choose. (9)

Exam-style questions on Topic 1.2

Don't rush; check your answers carefully.

1 Which **one** of the following is the best reason to use a market map before opening your first cafe? (1)

(a) It is a way of seeing whether there's a gap in the local market.

(b) It encourages deeper thought about how one thing leads to another.

(c) It encourages you to think 100 per cent positively, and therefore avoid the risk of negativity.

(d) It makes you balance rewards against risks.

2 Which **one** of the following is the best definition of market segmentation? (1)

(a) Dividing the market into small enough units to run a group discussion.

(b) Dividing the market into four boxes based on market share and market growth.

(c) Dividing customers up into different types to uncover new niches.

(d) Making sure to check every new idea out on the public, especially those in the target market.

3 Which **one** statement best describes the difference between qualitative and quantitative data? (1)

(a) Qualitative data can be tested for reliability; quantitative cannot.

(b) Qualitative data shows 'how'; quantitative shows 'why'.

(c) Qualitative data is good for sales forecasting; quantitative for finer judgements.

(d) Qualitative looks at the psychology of consumers; quantitative looks at the proportions thinking this or that.

4 Which **one** of the following groups are *all* examples of customer needs? (1)

(a) Quality, choice, convenience, competitiveness.

(b) Price, promotion, product and place.

(c) Choice, convenience, price, quality.

(d) Quality, reliability, durability and creativity.

5 Which **one** of the following is an example of primary research? (1)

(a) A discussion on new product ideas among a group of adults under-25.

(b) Checking official figures on population changes among under-10s.

(c) Googling to find any existing reports about the market you're interested in.

(d) Buying a market report from an established provider such as Mintel.

6 Which **two** factors are examples of a tougher competitive environment for a waffle bar? (2)

(a) Higher interest rates have increased its monthly payments to its bank.

(b) Waffles have featured strongly in a scene on the Love Island TV programme.

(c) Inflation has just hit a 12-year high.

(d) A new café is offering two free toppings on its waffles.

(e) Domino's has just added waffles to its takeaway menu locally.

7 Which **one** of the following only gives examples of ways to segment a market? (1)

(a) Location, age and competition.

(b) High price, low price, traditional and modern.

(c) Lifestyle, purchasing habits and behaviour.

(d) Gender, age and religion.

8 Look at the table of data on the UK market for mouthwash.

Which **two** of the following are correct statements? [2]

(a) Listerine sales in 2019 were £67.8m.

(b) Sales of Corsodyl rose by 9.0 per cent in 2020.

(c) Sales of Colgate were £25.9m in 2019.

(d) Sales of other brands amounted to £19.9m in 2020.

(e) Listerine's sales in 2020 were 53.1 per cent of total mouthwash sales.

	Sales in 2020	Change since last year	% change
Listerine	£68.1m	-£0.3m	-0.5%
Colgate	£28.1m	+£2.2m	+8.7%
Corsodyl	£14.4m	+£1.3m	
Dentyl	£2.7m	-£0.1m	-3.9%
Total market	£133.2m	+£1.4m	+1.1%

Source: *The Grocer*, 19 December 2020

Now try this discussion question.

9 Discuss the importance to a first-time entrepreneur of studying the strengths and weaknesses of competitors. [6]

13 Business aims and objectives

Aims are the broad targets that an entrepreneur has at the back of their mind (for example, 'to get rich'). These may or may not be talked about within the business, but eventually staff will come to understand them. For football managers like José Mourinho, the aim is always the same: 'winning'. Another manager might want to build a successful youth academy programme – but José has only one aim.

From aims come **objectives**. Aims are general but objectives are specific. To win the Champions League in the next three years is a precise objective. Businesspeople like to use the term **SMART objectives**. In other words objectives should be:

- **S**pecific
- **M**easurable
- **A**chievable
- **R**ealistic
- **T**ime-bound (that is, they have a precise timescale).

The value of clear objectives is that they give a clear sense of purpose that all employees can buy into. That, in turn, is motivating as staff try their hardest to achieve the objective. In a 2021 magazine interview, Ben Francis, founder of Gymshark, said: 'Like Nike is to America, I want Gymshark to be *the* UK fitness brand.' With that sense of purpose, he may well achieve it. A sense of purpose provides a focal point for staff activity and decision making.

Another example is Higgidy, started in 2003 by a husband-and-wife team who declared their objective as 'bringing posh pies into the reach of everyone'. As Figure 13.1 shows, this was clearly achieved by 2020.

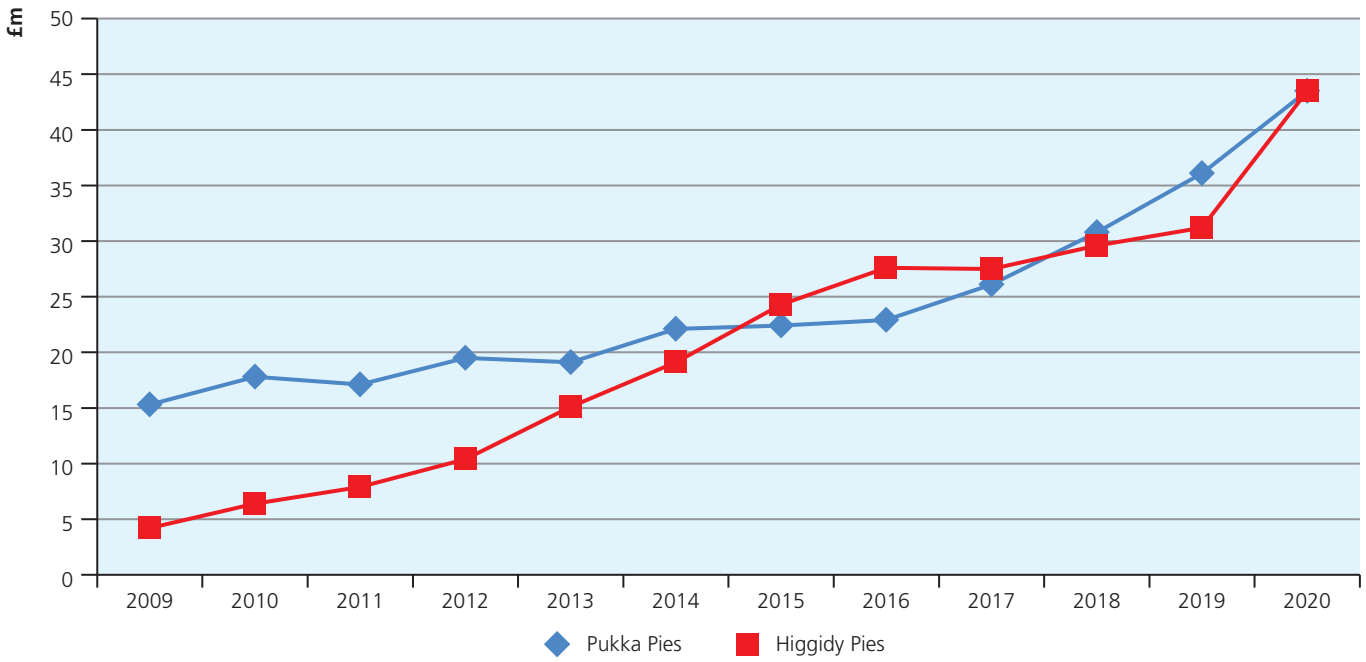


Figure 13.1 Giddy growth for Higgidy, 2009–20 (Source: *The Grocer* magazines, 2009–2020)

> The greatest danger for most of us isn't that our aim is too high and miss it, but that it is too low and we reach it.
>
> *Michelangelo, artist (1475–1564)*

Talking point

What personal aims do you hope to achieve by the time you're 22? What objectives might you set yourself to make sure you get there?

Why aims and objectives differ between businesses

Aims and objectives differ because business owners differ. Some have their sights set on money; others have a business idea first and see money as a secondary factor. Michael Dubin started Dollar Shave Club in the USA from disgust at how Gillette's dominance of the market for shaving had allowed the price of razors to reach crazy levels. The *Daily Mail* has claimed that Gillette products in the UK have a 4,750 per cent mark-up – this means that the selling price is 47.5 times more than the cost price, so products that cost £1 to make are sold for £47.50.

Many experts have said that the most successful businesses have an aim other than money. It is business success that leads to money being made. Ask Michael Dubin: Unilever bought Dollar Shave Club for $1 billion in 2016, before it had even made a profit.

People starting a new enterprise usually have one of three objectives:

1. A financial objective, such as to be rich.
2. A business objective, such as James Dyson in setting up his own bagless vacuum cleaner business – he was determined to prove that his idea would work.
3. A social objective, such as starting a charity aimed at improving water quality in African villages.

James Dyson wanted to invent a bagless vacuum cleaner

Financial objectives

When starting up, most entrepreneurs concentrate on **survival**. In other words, they want to bring in enough cash to pay the bills. This can be hard at the start, with too few regular customers to generate the revenues needed to outweigh the regular weekly operating costs.

Other financial objectives:

- Profit: at the least to make enough profit to pay the family bills, and at the most to make enough to make the family rich. Then there is the important issue of timescale: some entrepreneurs are desperate to prove themselves as quickly as possible. This may lead to corners being cut in pursuit of a quick fortune. Many a company has ended up exposed on *Watchdog* because of doubtful business practices. The best businesses are those with an eye to the long term, including parents who want to hand their business on to their children.
- Sales: some huge fortunes have been made in recent years by entrepreneurs who built sales and customer loyalty, but hadn't figured out how to turn the sales into profit. WhatsApp was bought by Facebook for $19 billion even though it only had sales, no profit; Dollar Shave Club was in the same position when it was bought by Unilever. The pursuit of sales first and profit later has become widespread for new online businesses.

- Market share: while sales are only about scale, market share is about power within a market; this, in turn, can secure a long-term profitable position. In 2020, a report on the market for chocolate in China placed Mars as number one, with a 40 per cent share. Of the top ten producers in China, nine are Western: Ferrero and Lindt have also been successful, though nowhere close to Mars. With high market share comes high distribution levels – in other words, shops want to stock you. That makes it easy for the leading brand to negotiate hard and charge high prices to the retailers.
- Financial security: having the biggest market share is one way to achieve financial security. Another way is to protect the idea behind your product from being copied by others. In 2010, Nestlé announced that it had taken out 1,700 patents on its Nespresso coffee-making system. Only after some key patents started to expire did Nespresso face serious competition.

> Focus on a few key objectives.
>
> *Jack Welch, former chief executive of General Electric*

Non-financial objectives

Some entrepreneurs are motivated by **social objectives**. The not-for-profit sector is becoming increasingly important. This refers to enterprises that are started with the objective of achieving a social goal, using business methods. A traditional example is a charity such as Oxfam, which is professionally run but has the goal of helping to relieve suffering in developing countries. Today, firms such as One (not-for-profit bottled water) attempt to achieve the same objectives. Between 2007 and 2020, One helped more than 600,000 people in Africa to get access to clean water.

Traidcraft is a leading social enterprise that began in 1979. It has built up its turnover to £12 million a year with all profits being ploughed back into the business. Traidcraft began the idea of 'trade not aid' by bringing coffee, tea and household items from developing countries and selling them in the UK. It helped to found the hugely successful Cafédirect and Fairtrade businesses. Because Traidcraft wants to encourage trade, even in a year when it made an operating loss (2019–20), it can console itself that its £3.3 million purchase costs represented income to developing country workers who produced the goods.

Other firms with social rather than profit-making motives include:

- the Co-operative Bank, which is owned by its members
- Waitrose and John Lewis, which are owned by their staff
- pressure groups, such as Greenpeace and Friends of the Earth.

Other non-financial objectives for starting a business:

- Personal satisfaction: for many people it is hard to get satisfaction from being a small cog in a big wheel. They need to break away and show what they can do. This is a particularly strong motive for those who have struggled to show their talents at school. There is a famously high correlation between entrepreneurship and dyslexia and other causes of school struggles. Richard Branson is perhaps the country's best-known person with dyslexia.
- Challenge: some people are mountain climbers and others prefer a walk in the countryside. Starting your own business is an extraordinary challenge that will test your personal skills, such as leadership, charm and the ability to plan and to prioritise; character traits, such as resilience, energy, dedication and persistence; as well as your intellectual abilities (intelligence). If that all sounds like too much pressure, stick to the country walks.
- Independence: entrepreneurs hate being told what to do; they value their independence greatly. This was especially the case for immigrants who, in the past, found their career progression blocked by discrimination. Independence remains a key attraction of entrepreneurship.
- Control: this is linked to independence. The entrepreneur demands to be in control. This is why

many entrepreneurs are reluctant to sell out for large sums of cash. The control they have within 'their' business is a drug that is hard to give up.

There is a strong correlation between entrepreneurship and dyslexia

Drawing the right conclusions

It is a mistake to think that business is just about making profits. People run businesses because they can be challenging, rewarding and fun. They also provide the scope to achieve social as well as financial progress. Nevertheless, there will always be some firms that are only interested in profit. These may become the cowboy builders who charge high prices for shoddy jobs, or the financial institutions that encourage young people to build up debts they cannot afford. Just as every individual is different, so is every business.

Revision essentials

Aims: a general statement of where you're heading, for example 'to get to university'.

Market share: the percentage of a market held by one company or brand.

Objectives: a clear, measurable goal, so success or failure is clear to see.

SMART objectives: targets that are specific, measurable, achievable, realistic and time-bound.

Social objectives: the possible goals of a business based on its contribution to society.

Survival: keeping the business going, which ultimately depends on determination and cash.

End of chapter exercises

1 Suggest one aim and one objective for a highly promising 15-year-old high jumper.

2 Suggest one aim and one objective for a 21-year-old about to start her first business (a body-building gym).

3 Explain why Traidcraft can feel happy about its 2019–20 performance, even though it made no profit.

4 Read the following extract and answer questions (a) and (b).

Johnno's jams were famous in the family. Everyone loves strawberry jam, but after a jar homemade by Johnno, nothing else seemed the same. So, it was no shock when, one Christmas, he talked to everyone about starting a jam-making business and asked if anyone could invest £10,000. With six relatives and £20,000 of his own, Johnno was ready to start. He went to three courses about food hygiene then set to work turning an empty factory unit into a jam production line.

(a) Discuss what financial objectives Johnno should set for the business in its opening year.

(b) To what extent can Johnno trust that the quality of his jam will pull him through the difficult start-up phase of the business?

Practice questions

Financial vs non-financial aims

Gousto, the UK's number one recipe box provider, started in 2012 and a year later was turned down for investment on the BBC's *Dragons' Den*. Since being turned down, the business has grown remarkably, with sales hitting £189 million in 2020.

Gousto has a very clear objective. Timo Boult, the founder and chief executive, says he wants Gousto to become 'the most-loved way to eat at home'. He acknowledges what a huge ambition that is, as it implies beating the supermarkets at their own game. Direct competitors would be Waitrose and Marks & Spencer, both keen to sell ready-to-eat meals to those on their way home from work.

An important aim for Gousto is that its customers should see the service as environmentally friendly. It says its computer-based forecasting systems enable it to keep food wastage down to 12 per cent, compared with 20 per cent in supermarket supply chains. And the precisely measured recipes mean less food waste at home. The company has always made great use of social media to get messages such as this across to young adults.

Having finally become profitable in 2020, Mr Boult is very optimistic about the company's future.

Total: 20 marks

1 (a) Using the information in Figure 13.2, calculate the percentage growth rate in sales between 2017 and 2020. (2)

(b) Explain one reason why it might be hard to manage a business that is growing so fast. (3)

2 Analyse the benefit to Gousto of focusing on non-financial objectives. (6)

3 Gousto did brilliantly in 2020, when Covid-19 lockdowns made people use delivery services more often. Now Timo Boult must decide on his future plans. He is torn between two aims:

- Option 1: Focus on building up Gousto's market share, making it hard for new companies to break in to the market.
- Option 2: Keep non-financial objectives as the priority for Gousto.

Justify which **one** of these options he should choose. (9)

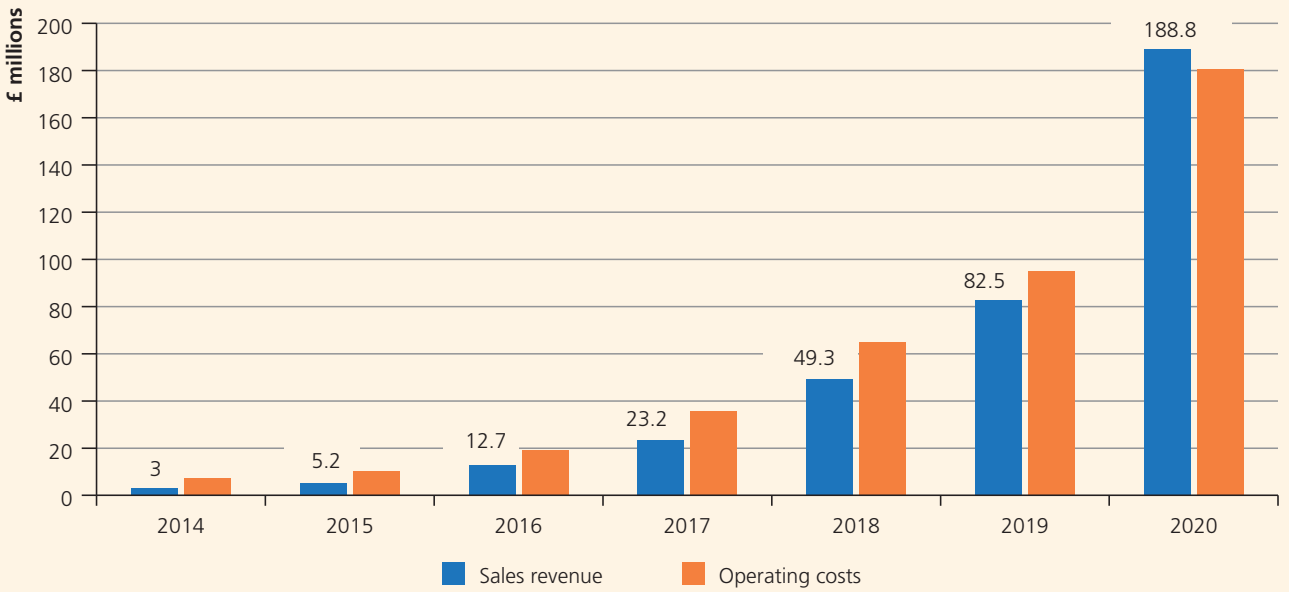


Figure 13.2 Gousto revenue and costs

14 Business revenue, costs and profit

Revenue

Sales **revenue** comes from the number of things you sell multiplied by the price you charge. If Yeovil Town FC sells 7,000 tickets at £20 each, its revenue is £140,000. Yeovil decides its own ticket price, so the uncertain factor is the level of demand. Will it sell 7,000 tickets (£140,000) or 5,500 tickets (£110,000)? Even for such a well-run club, the difference of £30,000 is very important.

The formula is:

revenue = quantity × price

Price

For some businesses, price is out of their control. In Africa, farmers producing cotton were receiving $3.12 per kilo in June 2016, but by July 2021 they were receiving only $2.37. The near 25 per cent fall in their incomes would have hit their already low living standards.

Prices cannot be estimated with confidence when:

- the business operates in a market where prices change in the short term due to variations in supply and demand, for example cotton
- competition is direct and fierce, for example Ryanair competing with easyJet
- you are launching a new product and cannot be sure of the consumer response; for example, Ferrero Rocher chocolate bars have a 2021 launch price of £2 per 90 g bar. Will the brand sustain twice the price of Cadbury's Dairy Milk? Or may it start to have special offers at lower price levels?

Talking point

Richard Branson's Virgin Galactic plans to offer space tourism: five minutes of weightlessness in space. How might he decide on the right price per flight?

Quantity (demand)

Occasionally, the demand for a product or service can be judged with confidence. Beyoncé's concert tours have always sold out so it seems safe to expect them to sell out next time round. Similarly, sales of Heinz baked beans are extremely predictable. A revenue forecast made for six months' time by a Heinz director would prove very accurate; therefore the business can make sure it has the right quantity of machinery, staff and raw ingredients. Managing this type of business is easy.

It is quite different when trying to plan the revenues for an upmarket London restaurant. Customers will usually be a mixture of wealthy Londoners, businesspeople and visitors to London. The restaurant could be full this week, but in six months it might have been emptied by:

- a newspaper review that condemns it as dull and overpriced
- an economic slowdown, leading to cutbacks in luxury spending
- concerns about pandemic infections internationally.

Worked example: revenue

1 A baker sells 120 loaves of bread a day at £2.50 each. What is the baker's daily revenue?

120 × £2.50 = **£300**

2 XYZ Ltd has two main products: A and B. Sales of A are 2,000 units a month; sales of B are 500 units a month. The selling prices for A and B are £4 and £10, respectively. Calculate the revenue.

Revenue = sales volume × selling price
Product A: 2,000 × £4 = £8,000
Product B: 500 × £10 = £5,000
So, total revenue = **£13,000**

Costs

What do you think it would cost to start up a kiosk selling £2.50 coffees? The shot of real coffee costs 12p, then there's milk and sugar, no more than 3p. Allow 10p for the paper cup and the direct cost of making a cup of coffee is 25p. You can sell it for £2.50 yet it costs only 25p to make.

Of course, it is not that simple. There are many other costs: the cost of the kiosk, the cost of machinery, the salaries of the staff and the accountant you need to prevent the taxman from hunting you down.

For someone starting a business, identifying and quantifying all the costs is one of the hardest things to do. The starting point is to realise that there are two types of cost: **variable costs** and **fixed costs**.

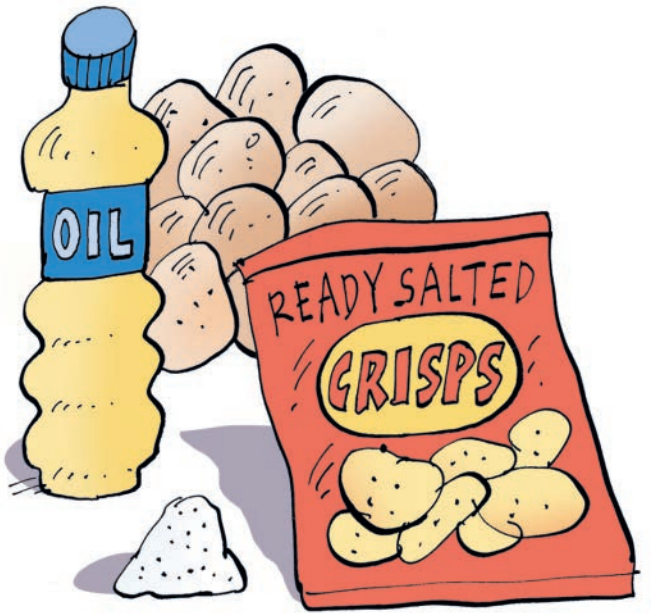
Coffee costs barely anything to make but can be sold for a much higher price!

Variable costs

These are costs that vary with the quantity sold and, therefore, the quantity made. They are costs that relate directly to making the sale and, therefore, making the product. If Walkers runs a brilliant new advertising campaign and crisp sales double, they will have to buy in twice as many potatoes, twice as much packaging, and so on. These are variable costs. They rise and fall in relation to sales and, therefore, output.

Examples of variable costs include:

- raw materials (for example, potatoes for making crisps, coffee beans for making coffee)
- bought-in components (for example, spark plugs for making cars, zips for making jeans)
- energy used in the production process (for example, electricity to power the coffee-making machine).



The raw materials involved in making potato crisps

Fixed costs

These costs do not change as output changes. They are fixed in relation to output. Take the rent on a clothes shop for example – it must be paid regardless of whether sales are terrific or awful. Therefore it is fixed. Note, though, that the landlord can put up your rent, so the fact that it is a fixed cost does not mean that it never changes.

Fixed costs are often related to a time period rather than sales or output. Rent, for instance, might be paid per month, as might staff salaries.

Examples of fixed costs include:

- salaries of permanent staff
- rent and (council) rates
- interest payments on borrowings.

Worked example: interest payments

1 A business took out a three-year loan for £8,000 at an **interest rate** of eight per cent. The £8,000 is to be repaid at the end of year three. Calculate the business' total interest payments.

Each year it must pay £8,000 × $\frac{8}{100}$ = £640

Over a three-year period, therefore, the payments come to £640 × 3 = **£1,920**

2 A business has an agreed overdraft limit of £20,000 at an interest rate of 12.5 per cent. Over the past year the business has, on average, run an overdraft of £15,000. What are the interest charges?

£15,000 × $\frac{12.5}{100}$ = **£1,875 for the year**

Getting the numbers right

If you plan to open a kebab shop, it may be easy to decide which are the variable costs and which are the fixed costs, but what will the *exact* figures be? The only way to find out is to work at it.

A trip to a local estate agent will tell you what rents are likely at different parts of the high street (they might vary from £2,000 to £8,000 a month, depending on location). The estate agent will also know the level of council tax/rates on different properties. A look at online job advertisements will show the hourly pay rates and salary levels locally. A few phone calls to insurance companies will give an idea of the insurance costs. A builder could give a quote on the cost of turning the shell of an empty shop into a kebab shop, with the electrics, gas and water in the right places. So, most of the fixed costs can be established fairly easily.

It may be harder to estimate the variable costs. An internet search would get you the names of doner kebab meat suppliers. If you were offered enough meat to make 450 kebabs for £135, it would cost just 30p per kebab! Of course, without experience you cannot be sure of the quality of the meat, or that you would really get 450 portions from it, so a sensible businessperson would be very cautious when estimating costs. To be on the safe side you could allow for 60p in meat variable costs (plus the cost of pitta bread, salad and so on – so perhaps £1 in total).

Getting research done

Having completed your research, you can estimate the following totals:

- fixed costs of the kebab shop: £1,200 per week
- variable costs per kebab: £1.

You can now calculate the **total costs** at different levels of business. If research shows that 600 customers will come per week, your total weekly costs will be:

600 × £1 = £600 (variable costs) + £1,200 (fixed costs) = £1,800 (total costs)

As long as the revenues are higher than this figure, there is money to be made.

Worked example: costs

1 A coffee shop has variable costs of 25p per cup and weekly fixed costs of £1,200.

(a) What are its total costs in a week when it sells 800 cups of coffee?

Total costs = variable costs + fixed costs
(£0.25 × 800) + £1,200 = **£1,400**

(b) What are its total weekly costs if sales double to 1,600 cups of coffee?

Total costs = variable costs + fixed costs
(£0.25 × 1,600) + £1,200 = **£1,600**

2 ABC Ltd sells motorbikes. It buys the bikes for £2,000 and sells them for £3,000. It also has weekly fixed costs of £4,000. Calculate total costs if six bikes are sold in a week.

Total costs = variable costs + fixed costs
(£2,000 × 6) + £4,000 = **£16,000**

Profit

Profit is the difference between revenue and costs. It is calculated by the formula:

profit = revenue – total costs

If costs are greater than revenue, the result will be a negative number. That means making a loss.

Look at the position of Whitbread, owner of Premier Inn. In 2019 it had a good year and made a profit of £486 million. In 2020 Covid-19 crushed its income, pushing it into a loss of £487 million. This turnaround came about through a huge reduction in revenue, with costs falling – but not enough to allow a profit to be made.

For new, small firms, profit can be very difficult to achieve in the early days. Costs may be higher than necessary because staff have not yet learned to do things efficiently. Revenues may be low because word has not yet spread about the quality of the service offered. W.H. Hales, a shop in Croydon supplying and engraving sports trophies, took five years to become profitable – it took that long for the word about the shop to spread among local football teams.

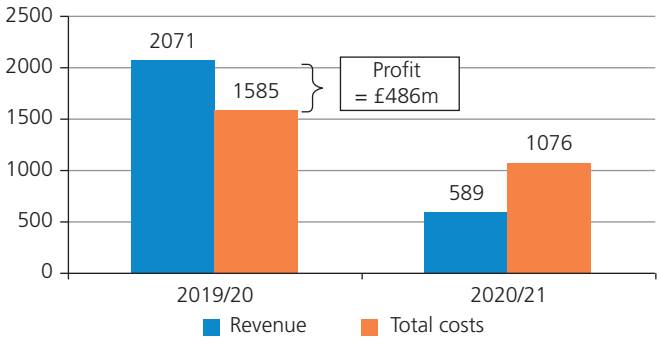


Figure 14.1 Revenue and costs at Whitbread/Premier Inn, 2019/20 and 2020/21 (Source: Whitbread plc accounts)

Worked example: profit

1 A coffee shop has variable costs of 25p per cup and weekly fixed costs of £1,200. It sells each cup of coffee for £2.

(a) What are its profits in a week when it sells 800 cups of coffee?

Profit = total revenue – total costs
Total revenue = 800 × £2.00 = £1,600
Total costs = (£0.25 × 800) + £1,200 = £1,400
Therefore, weekly profit is
£1,600 – £1,400 = **£200**

(b) What are its weekly profits if sales double to 1,600 cups of coffee?

Total revenue = 1,600 × £2.00 = £3,200
Total costs = (£0.25 × 1,600) + £1,200 = £1,600
Therefore, weekly profit is now
£3,200 – £1,600 = **£1,600**

2 ABC Ltd sells motorbikes. It buys the bikes for £2,000 and sells them for £3,000. It also has weekly fixed costs of £4,000. Calculate the profit if six bikes are sold in a week.

Profit = total revenue – total costs
Total revenue = 6 × £3,000 = £18,000
Total costs = (£2,000 × 6) + £4,000 = £16,000
Therefore, weekly profit is
£18,000 – £16,000 = **£2,000**

Talking point

Identify the different ways profit might be used at Liverpool Football Club and the charity Oxfam.

Drawing the right conclusions

To succeed in the long term a business must make profits. The surplus of revenue over costs provides the capital to replace tired machinery and vehicles and to finance growth. Many businesses have an occasional awful year, so having some cash in the bank is important to long-term survival and success.

At the time of writing, easyJet had announced a loss of more than £300 million in the three months April–June 2021. Covid-19 has not yet eased. But the chief executive said the business has enough cash reserves to get through this difficult period. Keeping profits back 'for a rainy day' makes good business sense.

Revision essentials

Fixed costs: costs that don't vary just because output varies, for example rent.

Interest: the charges made by banks for the cash they have lent to a business, for example six per cent per year.

Interest rate: The annual cost of a loan to the borrower.

Profit: the difference between revenue and total costs; if the figure is negative the business is making a loss.

Sales revenue: the total value of the sales made within a set period of time, such as a month.

Total costs: all the costs for a set period of time, such as a month.

Variable costs: costs that vary as output varies, such as raw materials.

Formulae

Sales revenue = price × quantity sold

Total costs = variable costs + fixed costs

Profit = total revenue – total costs

End of chapter exercises

1 Explain the difference between fixed costs and variable costs.

2 A greengrocer buys punnets of strawberries for 50p and sells them for £1. She must also pay £120 in weekly rent and £180 for other fixed costs.

(a) Calculate the total cost of selling 500 punnets per week.

(b) Calculate the total cost of selling 1,000 punnets per week.

3 Identify two fixed costs and two variable costs of running:

(a) a secondary school with 1,200 pupils

(b) a Tesco supermarket.

4 Use the information in Figure 14.1 on page 74 to explain how the finances of Whitbread/Premier Inn were overturned from a £486 million profit to an almost equal loss.

5 Read the extract about Toni's ice cream. Calculate Toni's profit per day.

Toni's ice cream van sells 150 ice creams a day at £2 each. The variable costs are 40p per ice cream; the fixed costs of running the van are £100 a day.

Toni's ice cream van sells 150 ice creams a day

6 Toni's daughter wants him to put the price up to £2.40; she thinks that sales will stay at 150 ice creams, but Toni is worried that sales will fall to 125.

(a) Calculate the change in Toni's profit if his daughter is right.

(b) Calculate what the new profit will be if Toni is right about the effect of a price rise.

(c) Outline one reason why Toni might still want to keep the price at £2.

Practice questions

Choy Sum restaurant

When the Choy Sum Chinese restaurant opened in Wimbledon, it was in a great position to estimate costs accurately. The owners already ran a Chinese restaurant five miles away in Fulham, so they knew how much to allow for the variable and fixed costs of their new outlet. Before opening, their plans showed:

- average price per dish = £4.40
- average variable cost per dish = £1.80
- fixed weekly overheads = £2,000
- number of dishes sold per week = 3,000
- weekly revenue = £13,200

However, it proved harder than expected. The owners knew how much the ingredients *should* cost in a chicken and black bean sauce dish, but the actual variable costs were 25 per cent higher. The owners checked the figures carefully, trying to see whether staff were stealing food from the kitchens.

The explanation came in two parts. First, the restaurant manager at Wimbledon failed to attract and keep good chefs, so customers sent poor-quality dishes back to the kitchen and the cooking had to be redone. The second problem stemmed from the first: bookings were slow, with only 200 customers buying 1,000 dishes per week. Fresh food went off and had to be thrown away.

Total: 25 marks

1 Based on the owners' plan, calculate the expected weekly total costs. (2)

2 Based on the owners' plan, calculate the expected weekly profit. (2)

3 Analyse why sales proved lower than expected. (6)

4 Actual variable costs were 25 per cent higher than predicted, and the number of dishes sold was only 1,000. Calculate the weekly actual revenues. (2)

5 Based on the data provided in question 4, calculate the weekly actual total costs. (2)

6 When operating a Chinese restaurant such as Choy Sum:

(a) Identify one likely variable cost.

(b) Identify one likely fixed cost. (2)

7 To get the business into profit the owners see two options:

- Option 1: Focus all efforts on training and motivating the staff.
- Option 2: Focus on building customer numbers by advertising in local papers and on social media.

Justify which **one** of these options they should choose. (9)

Practice questions

Seaside ice cream

Pink's ice cream parlour

It wasn't your normal birthday present. Katy Alston was led outside by her husband and there, parked outside, was an ice cream van. The 'happy birthday' gave her the thrilled realisation – the van was hers. And so began 'Pink's Ice Cream'.

Katy gave up her nursing job and focused on building an ice cream business. It started in Mr Whippy style, with the van serving ice cream cones across the south of England. By reinvesting profits into the business it was possible to get a second van, branded Pink's Vintage Ice Cream – focusing on events such as weddings, 21sts and special occasions. An ice cream bicycle followed and in 2019 Katy was thrilled to open her first ice cream parlour, in Bognor Regis on the south coast.

The ice cream parlour was the first really big financial commitment, with the substantial fixed costs of a prime site near the seafront: rent, rates, electricity and all-year-round staffing. A very different business model from seasonal ice cream vans with seasonal staff.

Then, in March 2020, with a weather forecast for a sunny, ice-creamy April, came the first Covid-19 lockdown. Katy remembers 'sitting in my parlour absolutely sobbing'. With dozens of weddings cancelled and the shop closed, in May Pink's started offering deliveries of 'parlour at home' packs: ice cream, cones, toppings and sauces. But that did little to make up for lost revenue.

Now the battle is to keep the parlour open. Katy says, 'We thought there would be massive parties when lockdown was over, to help recoup some of our losses. But, of course, it hasn't happened like that.'

Others in the industry moan that whereas the government temporarily cut VAT from 20 per cent to 5 per cent for hot takeaway items, it didn't do the same for cold. So McDonald's and KFC are fine, but not small ice cream businesses. It doesn't seem fair.

Total: 20 marks

1 Outline how Pink's might be affected by seasonal sales by the seaside. (2)

2 Explain how 'substantial fixed costs' would affect a company's profit. (3)

3 Analyse how Covid-19 might have changed Katy's aims and objectives for Pink's. (6)

4 Pink's gets messages on its social media accounts saying that ice cream is unhealthy. Katy is thinking about two options:

- Option 1: Offer a range of sugar-free ice creams to boost revenue.
- Option 2: Cut the portion size while keeping the price the same.

Justify which **one** of these two options Pink's should adopt. (9)

15 Break-even

Tushingham Sails Ltd manufactures windsurf sails in Devon. The company has identified a potential market for a new design of windsurfing sail. Everyone who tries the sail reckons it will be a success. Tushingham will sell the sail online through its website, as well as in the 30 sports shops that stock its products.

Before going ahead, the company must make sure it can make some money out of the new sail. One way is to estimate how many sails it can sell then compare them with its **break-even** point. The break-even point is the number of sails the company must sell to cover all the costs of making them. Tushingham will make a profit if it sells more than this number. If it sells fewer, it will make a loss. Knowing the break-even level is important for any business.

> By failing to prepare, you are preparing to fail.
>
> *Benjamin Franklin, founding father of the USA (1706–90)*

Fixed and variable costs

As explained in the previous chapter, costs in a business can be divided into two types: fixed costs and variable costs. Before a business can calculate its break-even point, it must first collect information about production costs. A business will need to know its fixed and variable costs, and its sales revenue, if it wants to be able to calculate its break-even point.

The monthly fixed costs for the new sail are £18,000. Rental for the premises, managers' salaries and loan repayments are all examples of fixed costs.

The variable costs are £200 per board. The raw materials, packaging costs and so on, all go up and down in line with the number made and sold.

Tushingham Sails has carried out some market research showing that people are prepared to pay between £400 and £500 for a board, so the managers have decided on a selling price of £450. This makes it possible to calculate sales revenue at different levels of output.

Tom, the finance director at Tushingham Sails, has summarised these costs:

- Fixed costs: £18,000
- Variable costs per windsurf sail: £200
- Selling price per windsurf sail: £450.

Drawing a break-even chart

It can be helpful to draw a diagram that shows the profit or loss at every possible level of output. This diagram is called a **break-even chart**. To draw a break-even chart you need information about the:

- variable costs
- fixed costs
- revenue of the business
- maximum output of the business.

Tom would also need to know the following:

- total costs = fixed costs + variable costs
- variable costs = variable costs per unit × number of windsurf sails
- sales revenue = selling price per unit × number of windsurf sails
- that the maximum monthly production output of the factory is 200 units.

Stage one

Tom can now record the information on a **graph**, with quantity sold across the bottom and costs going upwards. The horizontal scale (across) runs from zero sold to the maximum possible, 200. The vertical (up) scale covers the range from £0 to the maximum revenue possible (200 × £450 = £90,000).

Below you can see the first stage of Tom's chart.

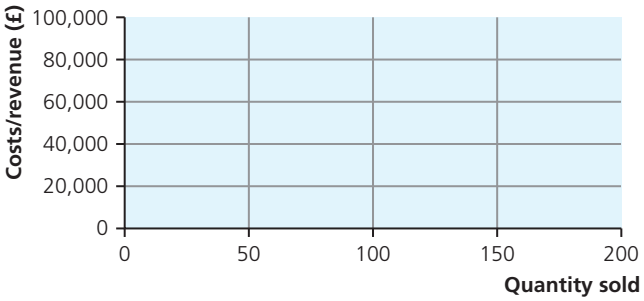


Figure 15.1 Stage one break-even chart

Stage two

Tom needs to draw his £18,000 fixed costs line on his chart (Figure 15.2). The line is horizontal because the fixed cost figure is the same no matter how many sails are sold.

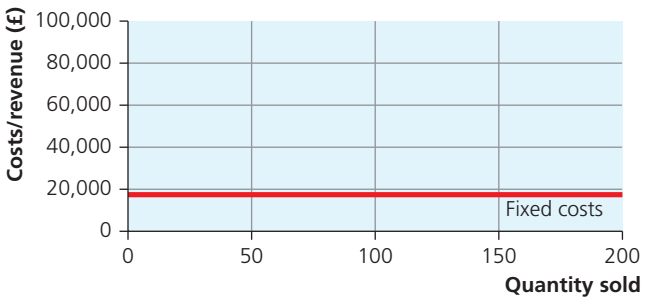


Figure 15.2 Stage two break-even chart

Stage three

Tom needs to show the total costs next (Figure 15.3). This means adding the variable costs to the fixed costs. If Tushingham sells nothing, its variable costs will be £0 (£200 × 0). If it sells 200 sails, its variable costs will be £40,000 (£200 × 200). These costs must be added to the fixed costs. So, the total costs line starts from where the fixed costs line meets the vertical axis (£18,000). The gap between the total costs and the fixed costs shows the variable costs.

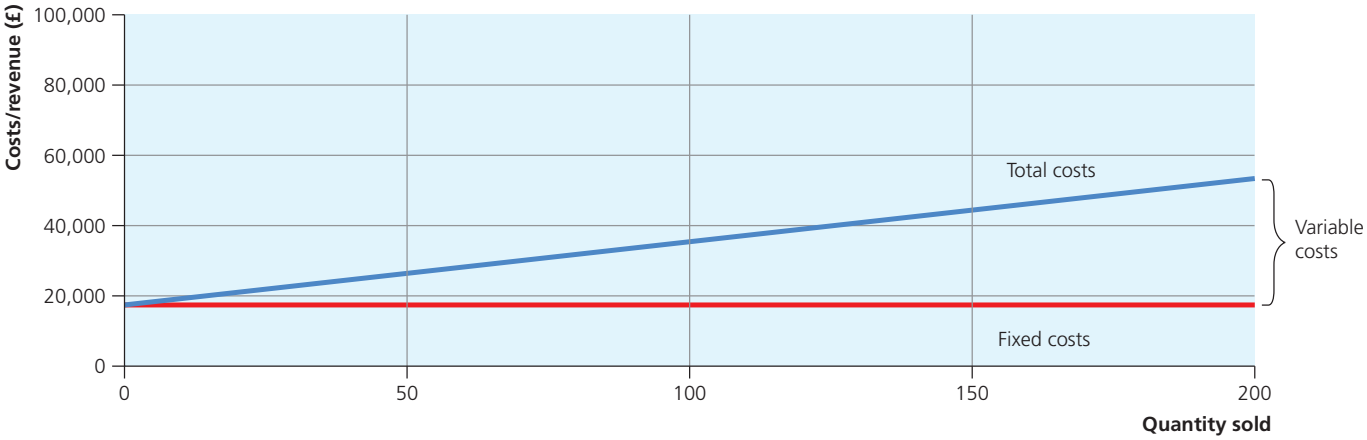


Figure 15.3 Stage three break-even chart

Stage four

The third line drawn shows Tushingham's income from sales – the revenue (see Figure 15.4). If no sails are sold, then no revenue is made (£450 × 0), so the line starts at zero. If customers buy all the sails, the sales revenue would be £90,000 (£450 × 200). So, revenue is a straight line between £0 and £90,000.

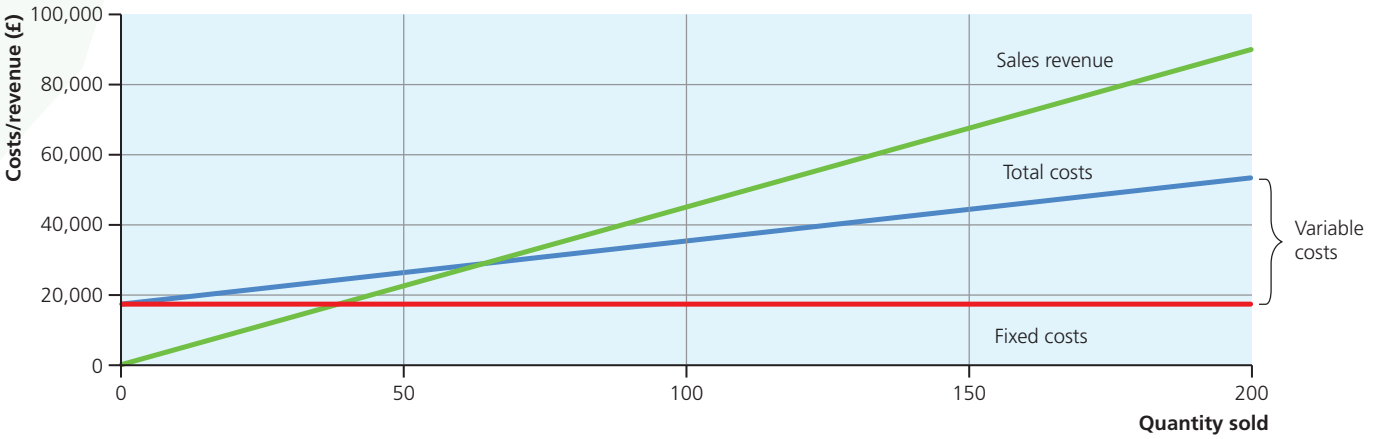


Figure 15.4 Stage four break-even chart

Stage five

The point on the chart where the sales revenue line crosses the total costs line is the break-even point (see Figure 15.5 on page 80). Tom can now draw a vertical line down to the quantity sold and identify the number of sails the firm has to sell in order to ensure that all costs are covered.

Tom reads the graph and can see that the line meets the horizontal axis at the number 72. This means that Tushingham needs to sell 72 windsurf sails before it starts to make a profit.

The distance between the revenue line and the total costs line shows the profit (or loss) made at that level of sales. After 72 sails have been sold, the difference between the two lines represents profit. From the graph Tom can calculate that Tushingham will lose £18,000 a month if it sells no windsurf sails, yet could make a maximum profit of £32,000 a month.

Talking point

Why is it important to think of future revenue as an estimate, not a fact?

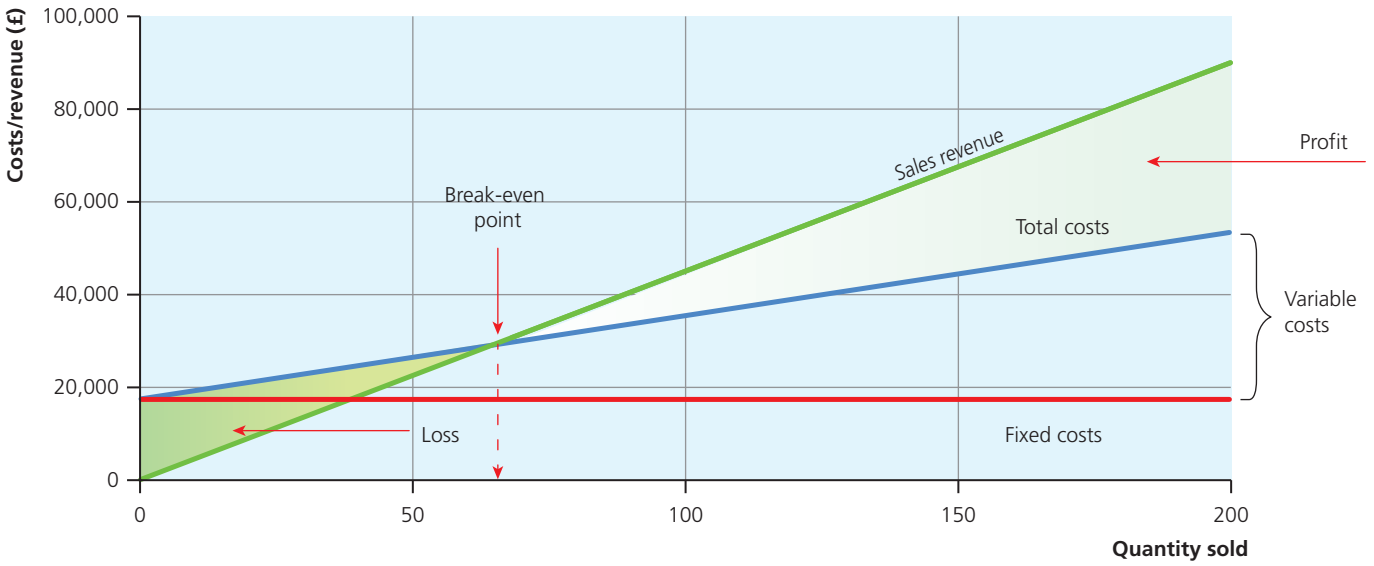


Figure 15.5 Stage five break-even chart

Calculating the break-even level of output

A break-even chart is useful but a bit time-consuming to prepare. If a manager wants to work out the break-even point quickly, there's a **formula** to do the job:

$$\text{Break-even} = \frac{\text{fixed costs}}{(\text{price} - \text{variable costs per unit})}$$

The answer is in units, not money.

First, work out the bottom bit, the price minus variable costs per unit. In the case of Tushingham Sails, that figure is £450 – £200 = £250.

Then apply the formula:

$$\text{Break-even} = \frac{£18{,}000}{£250} = \textbf{72 sails per month}$$

Margin of safety

A further use of the break-even chart is to show the **margin of safety**, that is, the firm's safety cushion. If a company's break-even point is 72 units but demand is 100 units, the business can afford sales to slip by 28 units before it starts to make losses. The margin of safety is the gap between sales and the break-even point. The wider that margin, the more comfortable the business can feel.

The formula for calculating this is:

Margin of safety = sales (in units) – the break-even point

Worked example: break-even and margin of safety

1 A pizza takeaway has 600 customers a week spending an average of £20 each. Variable costs per order are £5 and the weekly fixed costs are £3,000.

(a) Calculate the break-even point.

Price – variable costs per unit = £20 – £5 = £15

$$\frac{£3{,}000}{£15} = \textbf{200 customers per week}$$

(b) Calculate the margin of safety.

Margin of safety = sales – break-even point

600 – 200 = **400 customers a week**

Interpretation of break-even diagrams

Business is all about the future – making decisions today for the sake of things happening tomorrow. Therefore managers need methods that help them to make decisions. Break-even diagrams can help show the impact of changes in revenue and costs.

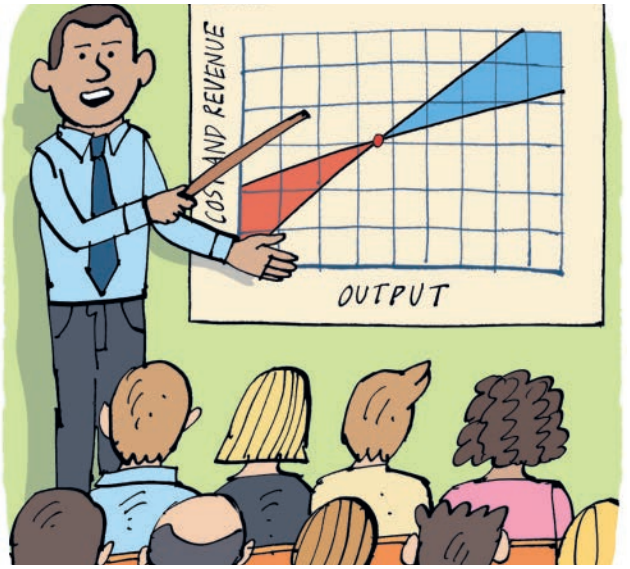
Break-even charts can help a manager answer questions such as:

- What if we put our prices up by ten per cent? What would this do to our break-even sales level?
- The price of wheat has risen by 25 per cent. What will this do to our profit if we leave our prices unchanged?

Table 15.1 (page 82) shows this in more detail, but the key thing is that these are critical questions for a business. They can all be answered on a calculator, but a break-even chart shows the answer visually. That will often make it easier to use, for example when explaining to staff why the business cannot afford to pay a five per cent pay rise at the moment, or why three staff have to be made redundant.

Table 15.1 How break-even helps answer business questions

Questions break-even can help answer	Impact on the break-even chart
Our landlord has increased our rent by 40 per cent. What will this do to our profitability?	Fixed costs line will rise, pushing the total cost line closer to the revenue line, i.e., cutting profits
The recession has cut demand for our organic eggs by 20 per cent. What will be the impact?	No lines on the chart will change, but the 20 per cent sales fall will reduce the margin of safety, or perhaps wipe it out
Is it right to cut our prices by 10 per cent? Will it increase or cut our profits?	The revenue line will rise less steeply, pushing it down towards total costs; profits can only rise if the sales volume leaps ahead



Critical business decisions can be answered with a calculator but a break-even chart shows the answer visually

Revision essentials

Break-even: the level of sales at which total costs are equal to total revenue. At this point the business is making neither a profit nor a loss.

Break-even chart: a graph showing a company's revenue and total costs at all possible levels of output.

Formula: a way of showing how the components of a calculation can be turned into an answer, for example, 'revenue – total costs = profit'.

Graph: data presented as lines, making it easy to identify trends, especially if 'time' is shown on the orizontal axis)

Margin of safety: the amount by which demand can fall before the business starts making losses.

Formulae

$$\text{Break-even output} = \frac{\text{fixed costs}}{\text{price} - \text{variable costs per unit}}$$

Margin of safety = sales – break-even output

End of chapter exercises

John sells hot dogs for a living. He calculates his fixed costs at £20 per day and his variable costs at 10p per hot dog. John sells each hot dog for 75p and is able to cook 50 hot dogs to sell every day.

1 Read the extract above. Calculate John's fixed costs if he makes and sells 25 hot dogs.

2 Calculate John's variable costs if he sells no hot dogs at all.

3 Calculate John's total costs if he sells 20 hot dogs in an afternoon.

4 Calculate the maximum sales revenue that John could take in one day.

5 Explain what is meant by the term 'break-even'.

6 Outline two reasons why a business might want to be able to calculate its break-even point.

7 Explain how to find the break-even point on a break-even chart.

8 Read the following extract and answer questions (a)-(c).

Toys 4 Fun is a manufacturer of children's wooden toys. The company has calculated the monthly costs of producing the average toy as follows:

Rent and rates	£2,000
Electricity	£100
Salary bill for managers	£2,700
Other fixed costs	£200

Average variable costs for producing each toy come to £5. The average price for each toy amounts to £25. The factory's capacity is 400 units.

(a) Calculate the total costs and total revenue of the business over the following outputs: 0, 200, 400.

(b) On a large piece of graph paper, draw a horizontal axis from 0 to 400 and a vertical axis from £0 to £10,000. Plot the revenue and total cost figures onto the graph and estimate the break-even output. What is the profit/loss at the following levels of output: 100 and 400?

(c) If the company could not sell more than 150 toys in a month, what might the management do?

Practice questions

Break-even crisis

Birmingham-based online travel agency TurkishHolidays.com enjoyed five good years followed by a sudden 66 per cent downturn in bookings to Turkey. The slump was due to a series of terrorist explosions followed by a violent, but failed, coup. Last-minute holiday bookings were especially hard hit, leaving places unsold.

The business was used to average weekly bookings of at least 240 holidays. Now the figure slumped to 80 holidays. As shown in the break-even chart, things were serious.

Total: 15 marks

1 Using the chart, calculate the profit or loss made by TurkishHolidays.com when bookings are 240 a week. (2)

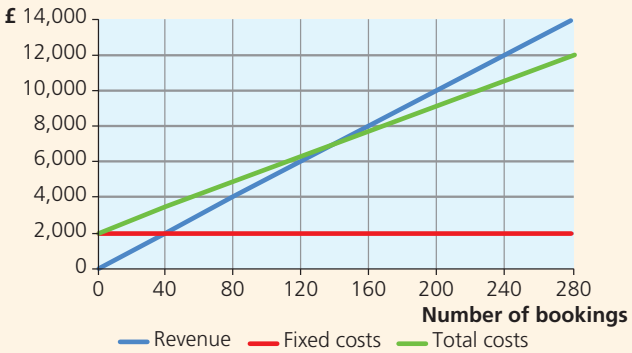


Figure 15.6 Weekly break-even chart for

2 Using the chart, calculate the profit or loss made by TurkishHolidays.com when bookings are 80 a week. (2)

3 Using the chart, calculate the company's safety margin when bookings are 240 a week. (2)

4 To get the business back into profit there are two options:

- Option 1: Cut costs to lower the break-even point.
- Option 2: Rebuild revenues, perhaps by offering new destinations such as Portugal.

Justify which **one** of these options the travel agency should choose. (9)

16 The importance of cash

Why does cash matter?

Cash matters because, without it, bills go unpaid and a business can be taken to court and perhaps closed down. Staff expect to be paid and will not accept a boss saying: 'Sorry, I can't afford to pay you today. Hopefully we'll be OK next week.' It is hard enough for individuals to *always* have cash available; if you are running a business with 15 staff and 150 customers, the problems are much greater.

There are two times when business cash flow problems are especially difficult:

1. At start-up, when money has to be ploughed into constructing (a restaurant, maybe), hiring, training and paying staff, buying in all the necessary equipment, then perhaps waiting several weeks until the word has spread and the restaurant starts to fill up. Any building delays or cost overruns may turn a cash balance into a worrying deficit.
2. At a time of rapid growth, when there can be serious strains on cash flow again. Your (small) restaurant is full every night and customers are grumbling about slow service, so you find a new, bigger site and get the builders in. Your cash drains away as you are constantly paying out. Many a growing business has collapsed at this point.

> In God we trust. All others pay cash.
>
> *American saying*

The importance of cash to a business

It is important, here, to realise that 'cash' – from a business point of view – means not only banknotes but also 'cash at bank', that is, money available in the business' bank account. Paying by electronic transfer or by debit card is essentially a 'cash' payment.

The main day-to-day cash payments made by companies are to their:

- suppliers, who usually give an interest-free credit period, such as 60 days to pay. If they're not paid on time, they may stop supplying – leaving your shelves empty. If you are a shopkeeper, it is embarrassing to have empty shelves. If you're a manufacturer, it is even more serious as a missing component can shut down the whole production line
- employees, such as footballers for Sheffield Wednesday Football Club, who were regularly paid late in the 2020–21 football season. Wednesday simply didn't have the cash. Needless to say, the best players will find another employer as soon as possible. And just as a sports team relies on its best players, a company relies on its very best staff
- paying the overheads, meaning all the bills that must be paid, whether or not the business is doing well. Typical overheads include:
  - salaries for office staff and for directors
  - rent and rates on the company's property
  - utility bills such as gas, electricity and phones. If the overhead bills are not paid, the lights could literally go out.

When you have a few large customers, if one of them fails to pay on time your cash position is squeezed badly. It can be even worse when a big customer collapses, as Cath Kidston did in 2020. At the time it went under, it owed £90 million to small company suppliers. They will have been expecting to receive money owed by Cath Kidston (perhaps £25,000), and suddenly realised that they would be receiving nothing.

> Happiness is a positive cash flow.
> *Fred Adler, New York venture capitalist*

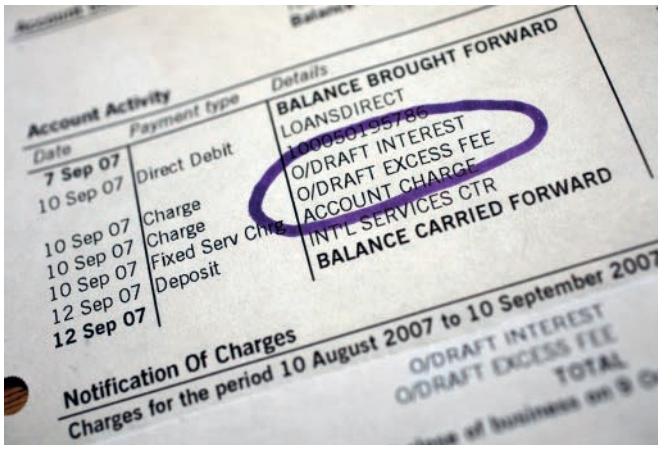
Sheffield Wednesday footballers were paid late due to a cash shortage

How should cash be managed?

The key is to forecast the flows of cash into and out of the business. This topic (**cash flow**) is covered in Chapter 17.

In addition to careful forecasting, a business must take care to:

- negotiate a generous **overdraft facility** at the bank. A bank **overdraft** is a flexible way to borrow what you want, when you want and for how long you want. If you have no cash in your bank but expect a fat cheque from a customer on Monday, you can pay your £7,000 salary bill today, Friday, using your over-draft. The cost of borrowing £7,000 for three days would be less than £5 – well worth it to keep staff happy. Overdrafts and other forms of borrowing are explained fully in Chapter 18
- keep costs under control. Cash should never be a serious problem if the business is profitable (that is, costs are lower than revenues). If business is poor, good managers make sure to cut costs – especially inessential ones such as staff mobile phones, expense accounts and renewing company cars
- keep the cash coming in. Most business in Britain is done on credit, not for cash. In other words, if Versace sells £400,000 worth of dresses to Harrods, the retailer may be given two or three months to pay. A poorly run business may be too soft on customers who fail to pay up on time. Companies allow customers an average of 70 days to pay up, but some allow over 120 days, which is four months! Waiting this long to be paid can strain a company's cash resources and is no way to run a business.



An overdraft can help overcome cash flow issues

Cash flow problems and business failure

Wilson's of Kendal Ltd collapsed in early 2016, making all staff redundant. The accountants brought in to close the business down blamed 'severe cash flow difficulties'. Wilson's had been making Kendal mint cake (effectively a slab of peppermint cream confectionery) since 1913. In 2013, the company responded to rising demand by investing in a brand new, bigger factory. It couldn't cope with the drain on its cash flow, however. It staggered on for a couple of years, shedding jobs, before closing down.

More than 120 staff lost their jobs. The business failed because it mishandled its cash flow. Technically, it fell into **insolvency**, meaning it was unable to pay its bills.

The difference between cash and profit

Every Saturday Jen works at her aunt's clothes shop. Last Saturday, for the first time, Jen was asked to 'settle up' at the end of the day. She counted all the cash and deducted the £40 'float' put into the till at the start of the day by her aunt. The net figure came to £422. Then she printed out the day's till receipts (showing the value of sales made in the day). That came to £1,376. Jen was baffled at that point, but her aunt printed out another sheet: the credit and debit card purchases made on the day. Happily that came to £954. Job done.

So, on Saturday £1,376 of revenue was generated, but only £422 of cash flow. The difference shouldn't matter much because the remaining £954 should come in from the card companies within a few days. But the principle is clear, cash inflow and revenue may be different, so cash flow and profit can also be different.

Table 16.1 How different financial actions affect cash flow and profit

Transaction	Effect on cash position	Effect on profit
Borrow £50,000 on a three-year loan	+£50,000	0
Sell £30,000 of goods for £40,000, giving the customer three months' credit	0	+£10,000
Pay a supplier £10,000 for goods bought on credit two months' ago	–£10,000	0
Sell £2,000 of fruit bought for £800 cash this morning	+£1,200	+£1,200

Cash flow shows the immediate impact of a transaction on a company's bank account; profit shows the longer-term impact.

Table 16.1 gives examples of key differences.

> The three most dreaded words in the English language are 'negative cash flow'.
>
> *David Tang, founder of Shanghai Tang*

Drawing the right conclusions

Cash is the lifeblood of every business. Literally, without cash the business dies. Therefore it is vital to plan how much is needed and where to get it from. The best possible source is from your own customers – making sure they pay on time. It is also necessary to allow for the unexpected, which is why a large overdraft facility is helpful. Ideally you would use it rarely, to keep interest charges down. When it is needed, however, its flexibility takes the pressure out of difficult financial situations.

Talking point

What cash problems might be faced by a manufacturer of fireworks?

Revision essentials

Cash: the money the firm holds in notes and coins, and in its bank accounts.

Cash flow: the movement of money into and out of the firm's bank account.

Insolvency: when a business lacks the cash to pay its debts.

Overdraft: the amount of the agreed overdraft facility that the business uses.

Overdraft facility: an agreed maximum level of overdraft.

End of chapter exercises

1. Why do businesses think that money in their bank accounts is part of their cash total?
2. How might a house-building firm suffer if it lacks the cash to buy supplies of bricks in bulk?
3. Outline two cash flow problems that a British seaside hotel business might have.
4. Before her first beauty salon opened, Moira Angell's builders took four months to complete the work – exactly double what they had promised. Outline two ways that this would affect the cash position of the business.
5. Look at Table 16.2, which shows the cash flow for a women's clothes shop. Suggest two ways in which the cash position of the business might be improved.

Table 16.2 Cash flow for a women's clothes shop

Figures in £000s	January	February	March	April
Cash at start of month	90	94	85	83
Cash in	24	16	18	22
Cash out	20	25	20	22
Net monthly cash flow	4	–9	–2	0
Cash at end of month	94	85	83	83

Practice questions

Oliver Adams

In May 2016, Northampton bakery Oliver Adams Ltd was forced to close nine shops, two of which were 'losing money hand over fist'. More than 20 people were made redundant. The 50-year-old business was first hit by a failed attempt at expansion. It bought two bakery chains in Birmingham that eventually had to be closed down. That, in turn, meant the central Oliver Adams bakery was underused, causing losses. Then, in 2015 and 2016, the supermarket price war saw bread prices fall by 20 per cent. Independent bakeries such as Oliver Adams suffered.

To resolve the company's cash problems, suppliers agreed to accept losses in the sums owed to them by Oliver Adams. The deal allowed Adams to keep going, saving 200 jobs in the short term. Sadly, in the years that followed the local paper reported a series of closures. In July 2019, for example, workers at one Oliver's bakery shop arrived in the morning to find the doors locked. They could see the inside had been cleared out; they were out of work. Oliver Adams Ltd was dissolved in July 2020. A slow death can be worse than a sudden one.

Total: 20 marks

1. Outline one possible explanation of why Oliver Adams faced such a cash flow crisis. (2)
2. Outline how the cash problems at Oliver Adams might have been helped if the business had a large enough overdraft facility. (2)
3. Define the term 'losses'. (1)
4. Outline one reason why closing more shops might make the company's problems worse. (2)
5. Define the term 'suppliers'. (1)
6. Evaluate the possible effects on a supplier to Oliver Adams Ltd if it suddenly becomes clear that a large outstanding bill will not be paid. (12)

Practice questions

On-trend pizzas

The extremely successful Wild Food Café

In December 2018, Joel and Aiste Gadzar did one of the riskiest things in business: opened their second restaurant. It was made all the more risky because London in 2018 saw a record number of restaurant closures.

The Gadzars had two huge strengths. First, their Wild Food Café in Covent Garden was successful and right on-trend with its combination of vegan food and healthy cooking methods. Second, they had waited seven years to open this second restaurant: time enough to save the cash needed to invest in the new opening.

Despite this, they needed to think carefully about cash flow. Opening a new London restaurant can easily cost £100,000. And then there's the period after opening, when it can take time for new customers to become regulars – and therefore keep the tables filled.

Once the doors open, there's the weekly pressure to pay the wages and other fixed costs, plus the suppliers. Fortunately the suppliers are likely to provide goods on credit for a business with a strong track record. But that puts off the payment for perhaps only a month. Often the biggest problem comes from the inexperience of the new staff. Wastage in food preparation is a huge issue for restaurant owners – and it inevitably rises as new staff try to get used to a new menu. The gluten-free, wood-fired pizzas may come out a bit burnt – and have to be thrown away. And the vegan salad ingredients get tired – and must be binned. The Gadzars had proved good cooks and excellent managers of staff – but could they get their cash flow forecast right?

Table 16.3 Cash flow forecast for the new restaurant

All figs in £000s	Month 0	Month 1	Month 2	Month 3	Month 4	Month 5
Opening balance	120	20	5	0	3	9
Cash inflow	0	60	**b**	80	85	85
Cash outflow	100	75	75	77	**c**	79
Net monthly cash flow	(100)	**a**	(5)	3	6	6
Closing balance	20	5	0	3	9	15

In the forecast in Table 16.3, Month 0 represents the 6-month period of constructing the new restaurant and up to the doors opening at the start of Month 1. Made a month before opening, the forecast may prove overly optimistic, in line with the owners' personalities. In the table, all the figures are in £000s and negative numbers are in brackets.

Sadly, the Wild Food Café restaurant business collapsed in the face of cash flow difficulties and Covid-19 lockdowns. Being on-trend is important, but no guarantee of success.

Total: 20 marks

1. Explain why it may be easier to get credit from suppliers when opening a second restaurant. (3)
2. Outline which part of the Gadzars' cash flow forecast might be affected by pizzas being burnt and thrown away. (2)
3. Using the information in Table 16.3, calculate the missing values of **a**, **b** and **c** within the cash flow forecast. (3)
4. Evaluate the impact of cash flow problems on the collapse of the Wild Food Café business. You should use the information provided as well as your knowledge of business. (12)

17 Cash flow forecasts

Cash flow is the difference between the flows of cash into and out of a business over a period of time. For example, if a company starts up by spending £20,000 of cash on premises and stock in its first month, but receives only £1,000 from sales to customers, its month 1 cash flow is *minus* £19,000.

Cash flow forecasting means predicting the future flows of cash into and out of the business bank account. In effect, it means forecasting what the bank balance will look like at the end of each month. A cash flow forecast will usually be for a 12-month period. Table 17.1 shows the forecast cash flow for the first six months of a brand new nightclub started with £250,000 of capital.

The forecast is based on some key points:

- Building work finished by the end of September, so customers could start coming in October.
- A launch party brings the publicity and customers needed for success.
- Costs prove as expected, but still the business has to dip into the overdraft in September.

> The most important word in the world of money is cash flow.
>
> *Robert Kiyosaki, author of* Rich Dad Poor Dad

Successful cash flow forecasts require:

- accurate prediction of monthly sales revenues
- accurate prediction of when customers will pay for the goods they have bought
- careful allowance for operating costs and the timing of payments
- careful allowance for other flows of cash, such as cash outflows when buying land, and inflows from raising additional capital, perhaps from selling shares.

This level of accuracy is very hard to achieve, especially for new, small firms. This is a key reason why the failure rate is so high among new firms. If cash flow proves much worse than the forecast, banks can be unforgiving. If a firm enters a period of **negative cash flow** without having discussed it with the bank, the consequences can be serious. If

Table 17.1 Forecast cash flow for a new nightclub

Figures in £000s	August	September	October	November	December	January
Opening balance	250	65	–10	0	5	35
Cash inflows	0	0	85	65	115	55
Cash outflows	185	75	75	60	85	60
Net cash flow	–185	–75	10	5	30	–5
Closing balance	65	–10	0	5	35	30

a bank loses confidence in a client, it can insist on the overdraft being repaid within 24 hours. This is likely to make it impossible for the business to continue trading.

> The three most important things you need to measure in a business are customer satisfaction, employee satisfaction, and cash flow.
>
> *Jack Welch, former chief executive of General Electric*

The importance of cash flow forecasts

Forecasting cash inflows and outflows is always important, especially for three types of business:

- new firms
- fast-growing firms
- firms with erratic sales (for example, a firework factory that only really brings in cash in October and November – how will it pay its bills from January to August?).

A fireworks factory may only really bring in cash in October and November

Negative cash flow

When cash outflows are greater than inflows, the result is negative cash flow. In other words, the firm is operating in the red. This is sustainable for a few weeks or months, as long as the firm has an overdraft facility or other sources of capital. Ideally, though, the business should act to improve its cash flow.

There are many ways a firm can act to improve its cash position:

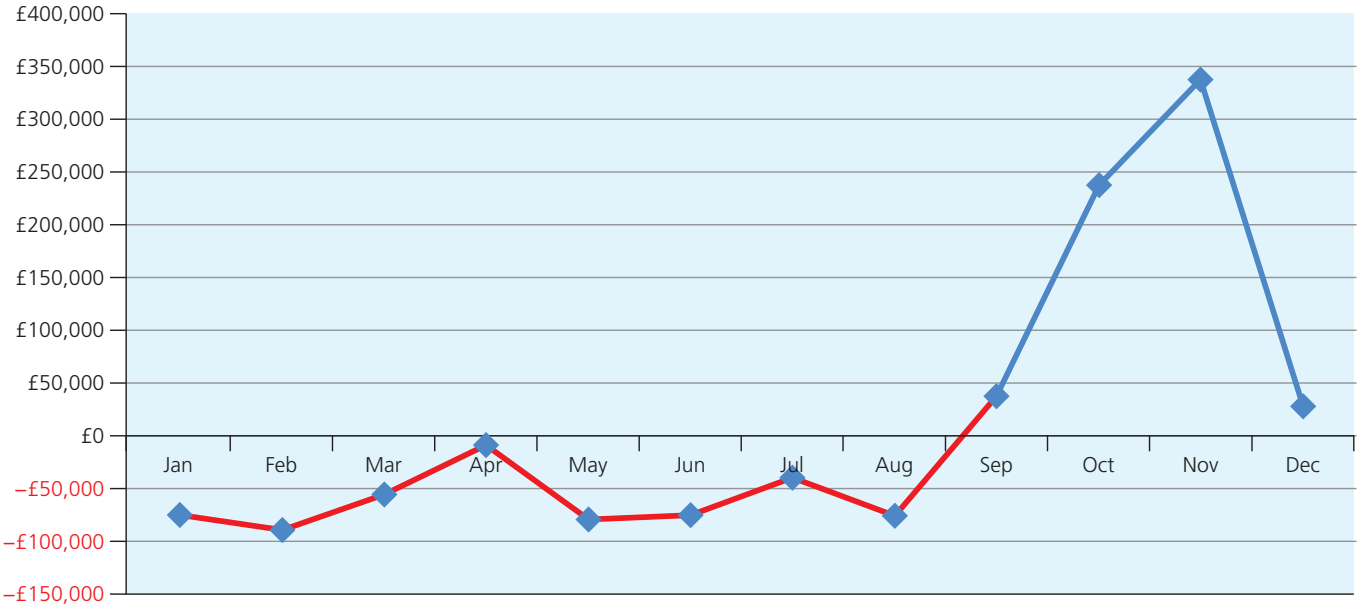


Figure 17.1 Monthly cash flow at a firework factory

1 Cut stock levels: that is, reduce the money the business has tied up in stocks of materials or finished goods. If a firm reduces its orders to suppliers, stocks will steadily fall and so too will the amount of cash tied up. A £40,000 reduction in the levels of stock being held will place £40,000 in the firm's bank account.

2 Increase credit from suppliers: that is, take a longer period before paying the companies that have supplied you with goods. This delays your cash outflows, which will improve the cash flow.

3 Reduce credit to customers: by giving customers less time to pay, you will get your cash more quickly. This may cause some problems if customers decide to go to someone else with longer credit terms. Overall, though, it may be better to deal with a few good payers than with some who take ages to pay.

Talking point

What has been your own worst-ever cash flow difficulty? Did you solve it? If yes, how?

Worked example: cash flow forecasts

1 There are ten gaps in this cash flow forecast, shown by letters A to J. Think about the numbers that should fill each gap, then check against the answer shown below.

Table 17.2 Cash flow forecast (incomplete)

Figures in £000s	January	February	March	April	May	June
Opening balance	50	30	70	**E**	100	**J**
Cash inflows	140	**B**	240	**F**	210	240
Cash outflows	160	180	**D**	220	220	220
Net cash flow	–20	40	60	–30	**H**	20
Closing balance	**A**	**C**	130	**G**	**I**	110

Answers and brief explanations are given in Table 17.3.

Table 17.3 Cash flow forecast (complete)

Letter	Month	Answer (in £000s)	Explanation
A	January	30	There was 50 in the bank at the start of the month, but the month's –20 net cash flow pulled the bank balance down to 30
B	February	220	Net cash = cash in – cash out 40 = ? – 180 Answer = 220
C	February	70	Closing balance = opening balance + net cash Closing balance = 30 + 40 = 70
D	March	180	Cash in – cash out = net cash 240 – ? = 60 Answer = 180
E	April	130	As March ended with 130, April must start with 130

Letter	Month	Answer (in £000s)	Explanation
F	April	190	Cash in – cash out = net cash ? – 220 = –30 Answer = 190
G	April	100	Closing balance = opening balance + net cash Closing balance = 130 + –30 = 100
H	May	(10)	Cash in – cash out = net cash 210 – 220 = –10
I	May	90	Closing balance = opening balance + net cash Closing balance = 100 + –10 = 90
J	June	90	As May ended with 90, April must start with 90

Talking point

Use Table 17.1 on page 89 to consider how worried a business should be if its latest month's cash flow is in the red.

Drawing the right conclusions

Careful cash flow forecasting is the single most important way to keep a bank manager's confidence. That, in turn, makes it easier and cheaper to borrow extra cash when the business needs it. The word 'careful' implies cautious. In other words, the bank manager will be impressed if a business keeps its forecasts of cash inflow quite low while expecting the worst of cash outflows. If the cash position turns out a little better than expected, who could object?

Revision essentials

Cash flow forecast: estimating the likely flows of cash over the coming months and, therefore, the overall state of one's bank balance.

Closing balance: the amount of cash left in the bank at the end of the month.

Negative cash flow: when cash outflows are greater than cash inflows.

Net cash flow: cash in minus cash out over the course of a month.

Opening balance: the amount of cash in the bank at the start of the month.

End of chapter exercises

1 Give two benefits of cash flow forecasting for a new, small firm.

2 Explain how the cash position of a clothes shop would be affected by having a '50 per cent off today!' sale.

3 A small hairdressing business decides to expand by opening up a second salon on the other side of town. Explain the probable effect of this on the cash flow of the business.

4 Explain in your own words why it is sensible to forecast cash flows cautiously.

5 For next March, JV Roofing Ltd forecasts an opening balance of £8,000, cash inflows of £22,000 and a closing balance of *minus* £5,000.

(a) Calculate the forecast figure for cash outflows next March.

(b) Give one possible reason why the forecast outflows may be so high that month.

6 Explain why it may be hard to forecast future cash flows with accuracy.

Practice questions

Waitrose announces speedier payments

Many small companies gave a sigh of relief when upmarket grocery chain Waitrose announced that it would start paying its smallest suppliers within seven days. This would help 600 small suppliers, each of which sells a maximum of £100,000 of goods a year to Waitrose. Waitrose claimed that it was part of its commitment to ethical trading. Sceptics pointed out that Tesco had recently done the same, and that 600 lots of £100,000 represented no more than one per cent of Waitrose purchases.

Waitrose pays its smallest suppliers within seven days

Nevertheless, for companies such as Oppo Brothers (a manufacturer of expensive, low-calorie ice cream) the Waitrose decision was extremely welcome. With sales booming and cash flow under strain, speedier payments from a major customer would be more than welcome.

Total: 15 marks

1 Define the term 'cash flow'. (1)

2 Outline one effect of speedier supplier payments on Waitrose's own cash flow position. (2)

3 Evaluate whether Waitrose was right to make this gesture to 600 of its smallest suppliers. You should use the information provided as well as your knowledge of business. (12)

18 Sources of small business finance

When raising finance there are three vital questions to ask:

1. How secure is the source? Capital raised by selling shares is kept within the business permanently, so it is 100 per cent secure. Bank overdrafts, by contrast, can be cancelled at any time, allowing the bank to demand its money back within 24 hours.
2. How expensive is the source? Capital can be expensive to obtain when starting a business because investors want high rewards to balance against the risk of possibly losing the money they have invested.
3. Is enough being raised? Because capital is hard to raise and expensive to manage, many businesses raise just enough to cover their expected needs. Unfortunately, it is hard to anticipate all possible problems in starting up and running a business, so it is wise to obtain at least 25 per cent more finance than seems necessary. This provides a safety net.

Short- and long-term finance

When raising finance, the first question to ask is about the timing of the cash requirement. Is the finance needed for a few weeks or for several years? If a business wants to buy a ten-year lease on a shop, there is clearly a need for ten years of financing. Therefore, it would be wrong to finance this via an overdraft, which is a useful but expensive way of borrowing money in the short term.

The rule is simple: short-term needs require short-term finance; long-term needs require long-term finance.

Long-term finance can be used to:

- provide start-up capital to finance the business for its whole life span
- finance the purchase of assets with a long life, such as property and buildings
- provide capital for expansion, such as building a new, bigger factory or buying up another business.

Short-term finance can be used to:

- get through periods when cash flow is poor for seasonal reasons (for example, a seaside hotel during the winter)
- bridge gaps when large customers delay payment, leaving no cash coming in to pay the bills
- provide the extra cash needed when a sudden, rush order requires a large sum to buy raw materials and pay overtime wages.

Short-term finance options help overcome situations where extra cash is suddenly needed

Sources of long-term finance

Personal savings

Most new businesses are financed mainly from the personal savings of the owners. This is usually necessary because outside **shareholders** and **venture capital** houses will only invest if they see that the owners are willing to put their own money at risk. Banks also like to see that the owners have been planning for years, as evidenced by regular saving. No one wants to risk their money on someone else's sudden whim.

Share capital

Ordinary shares give the buyer part-ownership of the business. If you buy 100 shares in a firm that has a total of 1,000 shares, you own ten per cent of the business. This gives you voting rights at the annual general meeting and entitles you to ten per cent of any **dividends** paid from the firm's profits.

For the business, **share capital** has two key benefits:

1. The business has the capital permanently. If shareholders want to cash in their shares, they can only do so by finding someone else to buy them (usually through the stock market); they cannot get their money back from the company.
2. In a bad year no dividends need to be paid. While interest payments to banks must be paid no matter what, shareholders are not promised a dividend payment every year. So, if the firm cannot afford to pay dividends, it need not do so. This makes share capital a safer source of finance than bank loans.

Drawbacks to businesses of share capital:

- If lots of shares are issued, ownership gets spread thinly among many shareholders; this dilutes the power of the founders of the business. The key to retaining control is to keep hold of more than 50 per cent of the shares.
- If the business is listed on the stock exchange it becomes vulnerable to **takeover** bids. This might affect decision making within the firm, for example forcing the whole business to be greedier for profit than would otherwise be the case (because high profits mean a high share price, making the business expensive to take over).

Loans

Loans are usually obtained from a bank. They may be in the form of a mortgage for as long as 20 years, or a bank loan for five to eight years. The key features of loan capital are:

- interest payments must be paid on time or there is a risk of being taken to court and perhaps being closed down
- almost all loans are secured against the assets the firm owns; failure to pay means losing an asset, such as buildings, shops or lorries
- the interest charges may be fixed or variable. Some firms like fixed rates (for example, seven per cent a year fixed for the five-year life of the loan); others prefer variable rates.

If a loan isn't repaid, assets can be repossessed

> Neither a borrower nor a lender be; for loan doth oft lose both itself and friend.
>
> *William Shakespeare*

Venture capital

This is a combination of share and loan capital. Providers of venture capital will take risks as long as they can share in the rewards. Therefore, they want a share stake in the business, often in addition to offering a loan. For a young or growing firm, a venture capital company is more likely to provide finance than a large high street bank.

Talking point

In the TV series *Dragons' Den*, entrepreneurs are trying to get venture capital investment. Why might an entrepreneur prefer venture capital to loan capital?

Retained profit

Over 60 per cent of all funds for business expansion come from the profits made by firms. This is the ideal source of capital as it does not require the payment of interest charges or dividends. Well-run businesses fund as much of their capital needs as possible from the profits they make from their regular trading.

Crowdfunding

Crowdfunding means getting investment from a wide range of small investors, each paying for their shares online. This works perfectly for business ideas that are too risky for banks but interesting enough to attract ordinary people who may be investing for the first time.

Advantages to crowdfunding:

- Acts as a mixture of financing and market research: if investors aren't attracted to invest, perhaps the business idea isn't strong or distinctive enough (in which case the failure to finance the start-up may be a blessing in disguise).
- Provides an opportunity for penniless but talented people to achieve their dream start-up.

Drawbacks to crowdfunding:

- Crowdfunding works best when investors like the idea of the business; it works less well when the business is less interesting, such as street cleaning.
- Start-ups using the best-known crowdfunding site (Kickstarter) have only a 33 per cent chance of reaching their target rate of funding – two out of every three are disappointed. In the case of other crowdfunding sites, the success rate for new small companies can be as low as three per cent.

Sources of short-term finance

Bank overdraft

This is the most common form of finance. It must be understood in two parts. First, the bank grants the business (or individual) an overdraft facility, for example of £5,000. This provides the right to keep spending until the bank account is £5,000 in the red. The actual overdraft level is likely to vary day by day, and even hour by hour, as customers pay up or staff salaries are paid out. Figure 18.1 shows that financing cash flow is the main reason firms seek financial help; an overdraft is an excellent way to do this.

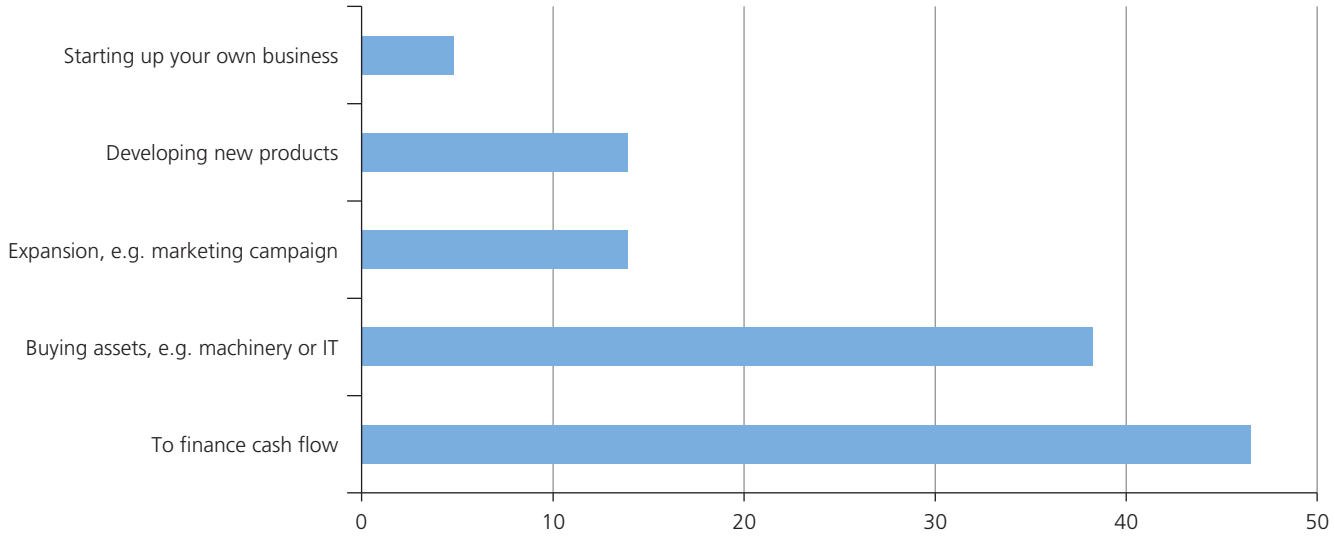


Figure 18.1 The main reasons small firms seek finance (Source: British Business Bank SBFM Report 2020)

Key features of a bank overdraft are:

- variable interest rate: the cost of borrowing money will change if UK interest rates change, which adds a degree of uncertainty to small business plans
- flexibility: instead of having a £5,000 bank loan, requiring payments each month based on the whole sum, a £5,000 overdraft facility need only be dipped into occasionally. So, if a firm only needs to borrow money for one day, it will pay 1/365th of the annual interest rate
- the bank can demand full repayment of an overdraft within 24 hours. Many firms that collapse financially were finished off by banks that make this demand.

> When you combine ignorance and debt, you get some pretty interesting results.
>
> *Warren Buffett, American business magnate and investor*

Trade credit

Small firms rely hugely on good relationships with their suppliers. Big companies can bully their way to get what they want from suppliers; small firms have to be nice or clever. If a supplier knows and trusts a customer, it may be willing to help when the customer is in need. A small clothes shop may be able to persuade Stella McCartney to keep supplying clothes even though earlier bills have not been paid. Getting a longer credit period is an effective way to raise short-term finance.

For small business start-ups, though, it is often impossible to obtain credit at the start. Suppliers demand to be paid cash in advance or on delivery. After all, they do not know whether you will be among the 30 per cent of firms that fail to survive their first year.

Drawing the right conclusions

When deciding how to raise capital, identify how much you need and how long you need it for. Broadly, there are three options:

1. loan capital
2. share capital
3. internal sources, such as reinvesting the profit the firm is making.

Most experts would then advise balancing out the capital; in other words, not relying too much on share capital and not too much on loans.

Revision essentials

Crowdfunding: raising capital online from many small investors (but not through the stock market).

Dividends: payments made to shareholders from the company's yearly profits. The directors of the company decide how large a dividend payment to make; in a bad year they can decide on zero.

Retained profit: profit kept within the business (not paid out in dividends); this is the best source of finance for expansion.

Share capital: raising finance by selling part-ownership in the business. Shareholders have the right to question the directors and to receive part of the yearly profits.

Shareholders: those who have bought shares in the business, giving them part-ownership and therefore, potentially, part control.

Takeover: obtaining control of another business by buying more than 50 per cent of its share capital.

Trade credit: when a supplier provides goods but is willing to wait to be paid – for perhaps up to three months. This helps with cash flow.

Venture capital: a combination of share capital and loan capital, provided by an investor willing to take a chance on the success of a small to medium-sized business.

End of chapter exercises

1. Explain why the founder of a business is likely to care about keeping 51 per cent of the business' share capital.
2. Identify whether the following situations require short- or long-term finance.
   - **(a)** A toy shop buying extra stock for the Christmas period.
   - **(b)** Buying land nearby in case it is needed for expansion.
   - **(c)** Redecorating your restaurant.
   - **(d)** Buying a new company BMW for the managing director.
3. Why may crowdfunding be a better source of external capital than venture capital?
4. Outline two possible advantages to an investor of buying shares in a business rather than lending it money.
5. Explain the difference between an overdraft and an overdraft facility.

Practice questions

Baby Suds: Cleaning up

Three years ago a young mum, Donna Morgan, started up her own business called Baby Suds. She invested £15,000 of her savings. A family member put in a further £30,000, taking 50 per cent ownership. The business idea was a range of affordable, fun children's shampoos that are kind to the skin. They managed to find a manufacturer who could produce the right products. Their eventual product line-up was:

- Baby Suds Pineapple Shampoo and Detangler
- Baby Suds Tangerine Hair and Body Wash
- Baby Suds Banana Shampoo and Conditioner
- Baby Suds 'Kind to Eyes' Baby Bath

After an unsuccessful meeting with Asda, Waitrose proved much more enthusiastic and ordered 200,000 bottles. This required £40,000 of capital to pay the manufacturer before the bottles could be delivered to the supermarket. The business could (just) afford this but, when sales took off, Waitrose placed a further huge order that made extra finance necessary. Morgan tried to sell more shares for £125,000, but eventually borrowed the money needed.

With just 15p of profit per bottle, the business required sales of at least 500,000 to cover its yearly fixed costs. In fact, by the end of its first year Baby Suds had made a profit of £61,000. With many other supermarkets queuing up to buy its children's shampoos, the business appeared to have succeeded.

Total: 20 marks

1. Outline one possible reason why the founders only used share capital to finance the start-up of Baby Suds. (2)
2. The manufacturer who produced the shampoos required to be paid in advance. Outline why it may not have been willing to give Baby Suds any trade credit. (2)
3. Given the information about the manufacturing costs of producing 200,000 bottles, calculate the cost per bottle to Baby Suds. (2)
4. Given the 15p profit per bottle, calculate Baby Suds' selling price to Waitrose. (2)
5. Evaluate whether an overdraft would be the best way to finance any further growth at Baby Suds. You should use the information provided as well as your knowledge of business. (12)

Practice questions

Gymshark: from university to £500 million

While still at Aston University in 2012, friends Lewis Morgan and Ben Francis started an online sportswear company: Gymshark. By early 2019 potential investors valued the business at £500 million. Lewis had been bought out in 2016, so 27-year-old Ben Francis was Gymshark's owner – and the one set to make a fortune.

Remarkably, by 2020 Gymshark had developed into a substantial business employing more than 400 people, yet without ever using any external, long-term finance. It had financed its expansion by reinvesting its retained profit. Ben was keen to build the business, not pay out huge dividends.

Gymshark began when fitness geeks Lewis and Ben saw an opportunity for design-led, high-tech alternatives to the ubiquitous Adidas and Nike sportswear. Clever use of social media and a well-designed, youthful logo and website helped the business to be profitable almost from the outset. As early as 2014 the online-only business made £1 million of operating profit. The firm, which has 5 million followers on Instagram and 260 staff, sends free products to social media influencers around the world, who often later share pictures of themselves working out wearing the gear.

'Our overarching focus, full stop, is to understand the 18–25 age group in our sector better than any brand in the world,' says Francis. 'For this generation, it's all about the experience and emotion. Price matters but more importantly it's about being part of something.'

At 60 per cent of sales, the USA is Gymshark's biggest market. The UK comes in second at 25 per cent, followed by the European Union at 15 per cent. Australia and Canada are growing markets – Gymshark switched on its Australian online store in July 2017. In 2019 and 2020 it opened online stores in Russia, India, Japan and South America.

So far, all production has taken place in Asia. This has kept costs low enough to provide high added value and profits from every sale. But the company says it wishes to switch to Portugal and other European production locations. Its huge profitability and worldwide sales potential means it has nothing to fear from Brexit.

Total: 20 marks

1 Calculate Gymshark's percentage sales growth between 2016 and 2020. (2)

2 Explain the value of retained profit in financing the growth of a business. (3)

3 Analyse the methods Gymshark has used so far to achieve its dramatic business growth. (6)

4 To maintain its high growth rate Ben Francis thinks that Gymshark should raise an extra £100 million of external capital. He has two options:

- Option 1: Raise this from loan capital.
- Option 2: Raise this from share capital.

Justify which **one** of these two options Ben Francis should choose. (9)

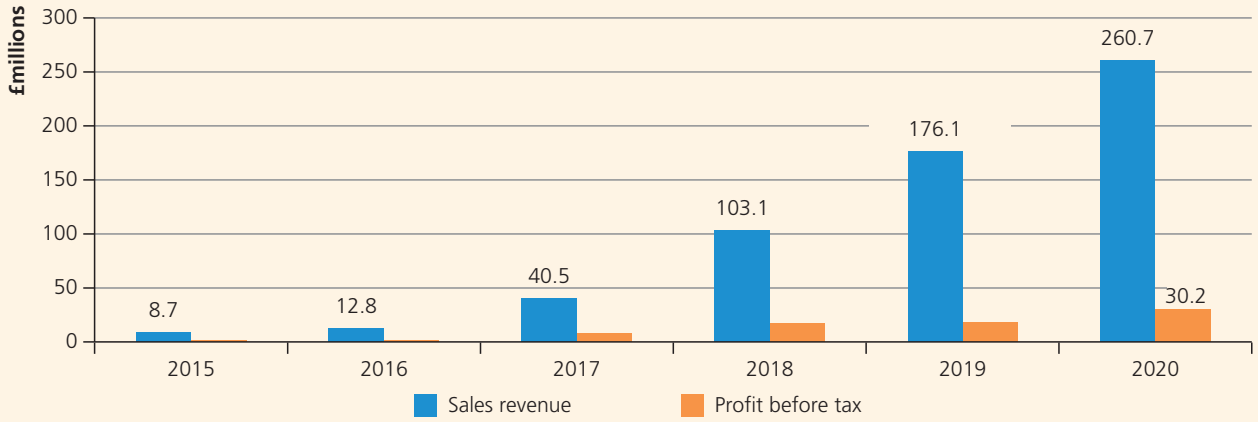


Figure 18.2 Gymshark Ltd's financial performance (Source: Gymshark accounts, Companies House)

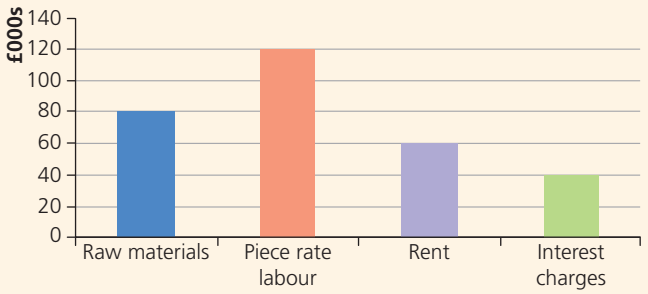
Exam-style questions on Topic 1.3

Don't rush; check your answers carefully.

1 The table below shows the cash flow for a small business. Work out the figures, A and B, missing from the table. (2)

	January (£)	February (£)
Receipts	7,200	8,000
Raw materials	1,400	1,600
Fixed costs	3,000	7,000
Total payments	4,400	8,600
Net cash flow	**A**	–600
Opening balance	400	**B**
Closing balance	3,200	2,600

2 Study this bar chart for XQ Ltd showing the total cost of producing 1,000 units. Calculate XQ Ltd's variable cost per unit. (2)



Bar chart for XQ Ltd

3 Which **one** of the following only lists long-term sources of finance? (1)

(a) Share capital, credit from suppliers and venture capital.

(b) Personal savings, loans and crowdfunding.

(c) Bank loan, retained profit and bank overdraft.

(d) Overdraft, trade credit and crowdfunding.

4 Which **two** of the following would be businesslike objectives for starting a socially minded sports club? (2)

(a) To gain a sense of achievement by creating something to be proud of.

(b) To build a business strong enough to be sold for a lot of money.

(c) To break even within the first two years.

(d) To find a way to franchise the business.

(e) To make the cumulative cash position of the club as high as possible.

5 Which **one** of the following is a correct formula? (1)

(a) Monthly net cash flow = cash at start of month + cash inflow

(b) Total variable costs = variable costs per unit x price

(c) Margin of safety = sales in units - break-even output

(d) Cash at month end = cash at month start - cash outflow

6 VX Ltd sells 800 units a week at £10 each. Fixed costs are £2,000 and variable costs per unit are £6. Which **one** of the following shows VX Ltd's break-even point? (1)

(a) £500

(b) 500 units

(c) 200 units

(d) £200

7 Bejax & Co makes kettles. Monthly sales are 5,000 units. Each one has a variable cost of £8 and they are sold to shops for £12. The fixed costs per month of running Bejax are £8,000. Which **one** of the following gives the monthly profit made by Bejax? (1)

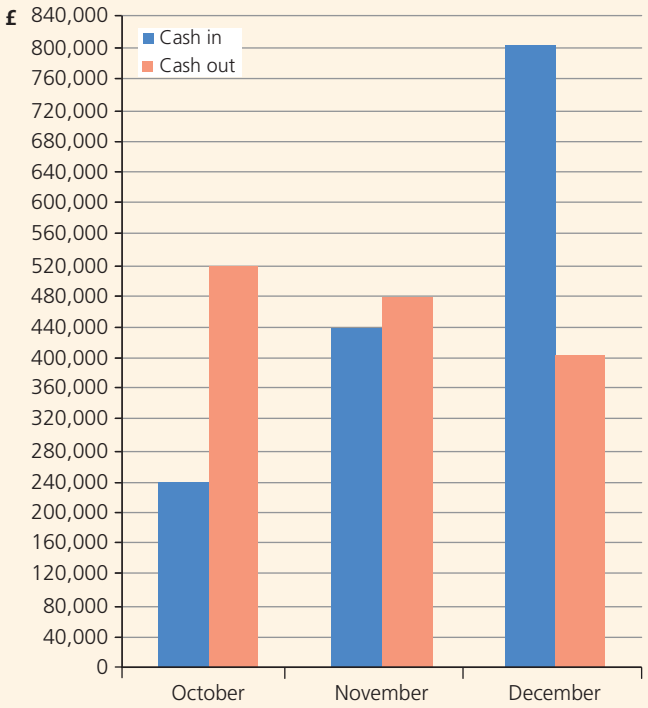
(a) £12,000

(b) £60,000

(c) £20,000

(d) £52,000

8 Calculate the net cash flow achieved by Hobart Ltd in the three months shown in the bar chart below. (2)



Net cash flow achieved by Hobart Ltd

9 Which **two** of the following would boost a clothes shop's cash flow? (2)

(a) An arrival of fresh stock

(b) Repaying a loan

(c) Slower payments to suppliers

(d) Giving customers longer to pay

(e) Cutting stock levels

Now try this discussion question.

10 Discuss the importance of cash flow to a growing young business. (6)

19 Ownership and liability

As many as half of all new businesses close down within three years. All business failures are painful, but there is a big difference between a company going into liquidation and an individual being made **bankrupt**.

When a company goes under, an independent accountant is appointed to try to raise as much cash as possible to repay the firm's debts. If there is a shortfall, the company's owners (the shareholders) do not have to repay the debts. The losses of the shareholders are restricted to the money they invested in the business. This is known as **limited liability**. By investing in shares, they took a risk, but their gamble can only cost them the amount they invested, not a penny more. Their liability is limited.

> Capitalism without bankruptcy is like Christianity without hell.
>
> *Frank Borman, astronaut*

By contrast, if the business had **unlimited liability**, financial disaster for the business will become a financial disaster for the owner or owners. Unpaid business debts could lead to the owner(s) losing their house, car and other possessions as part of bankruptcy proceedings. Yet this situation is completely unnecessary, as long as a business is run as a limited company. It is odd, then, that in 2020 there were nearly twice as many sole traders (with unlimited liability) as there were companies (with limited liability), as shown in Figure 19.1.

Unpaid business debts could lead to the owner losing his possessions as part of bankruptcy proceedings

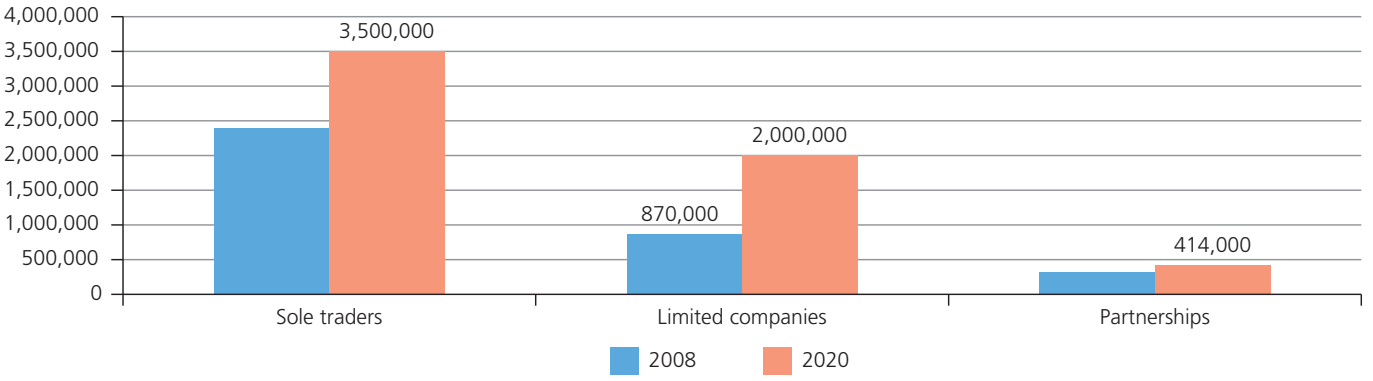


Figure 19.1 Growth in different types of businesses in England and Wales, 2008–20 (Source: ONS)

Limited liability

To achieve limited liability, a business must be started up as a company. This requires an application to Companies House and a payment of around £150. Once the right forms have been filled in, the business becomes a company. Small limited companies must put the letters 'Ltd' at the end of the company name. These businesses have **private limited company** status.

The fee of £150 is a small sum to pay for improved financial security. Other benefits from becoming a limited company include:

- a company can have share capital (perhaps 100 £1 shares), which makes it easy to divide up the ownership between different investors. As long as the company's founder keeps hold of 51 per cent of the shares, he or she still has total control
- if the business needs to raise more capital, it is quite easy to issue more shares for sale to other investors
- the business continues to exist even if the founder of the business dies. The company develops a life of its own
- due to limited liability, the owners/shareholders can be bold about investing in the future of the business. If a bold move goes wrong, the business may suffer but individual shareholders are not liable for the debts.

Given the advantages of limited liability, it is amazing that most businesses in the UK do not bother to turn into limited companies. Presumably the owners believe either that nothing can possibly go wrong, or that they will be able to cope financially even if something does go wrong. The clearest reason to avoid limited liability is that companies need to have their accounts drawn up by a qualified accountant. This means an annual cost of perhaps £1,500 to be paid to an accountant.

Talking point

Can it ever be wise for a business owner to sell a 50.1 per cent share in the business that they founded?

Unlimited liability

Anybody can start a business in the UK today. All that is required is to tell HMRC (Her Majesty's Revenue and Customs – the tax people). In few countries of the world is it so easy to start up. You would probably need a bank account, but this is unlikely to be a problem unless you are trying to borrow large sums from a bank.

However, unless the entrepreneur forms a limited company, the business and the person are one and the same for tax and legal purposes. This is why failure by the business leaves the entrepreneur liable in full for any debts.

A person running her or his own business without forming a company is called a **sole trader**. It is also possible to join with others in a partnership. Sole traders and partnerships both have unlimited liability.

The only logical reason for ignoring limited liability (forming a company) is if there is no realistic possibility of debts building up. For example, if the business is a market stall, and goods are bought for cash in the morning and sold out by the afternoon, it is hard to see how debts could be built up. So why bother with the cost and paperwork involved in setting up a limited company?

A person running their own business without forming a company is called a sole trader

Drawing the right conclusions

Everyone starting a business should think seriously about forming a company and, therefore, having limited liability. This is especially important if money is being borrowed to finance the business. Individuals with unlimited liability should not take risks with borrowing or with credit.

Table 19.1 Advantages and disadvantages of the three types of business for start-up

	Advantages	Disadvantages
Sole trader	Can start trading immediately Have 100 per cent control	Unlimited (personal) liability Have 100 per cent responsibility for the business, making holidays a problem
Partnership	Liability is spread between the partners Complementary skills may enhance the business	Unlimited liability, including for business debts caused by partner There may be clashes as one partner seeks overall control
Limited company	Limited liability Can sell shares to outside investors	Risk of losing control Cost of starting up and cost of getting accounts audited every year

Revision essentials

Bankrupt: when an individual is unable to pay their debts, even after all personal assets have been sold for cash.

Limited liability: restricting the losses suffered by owners/shareholders to the sum they invested in the business.

Private limited company: a small family business in which shareholders enjoy limited liability.

Sole trader: a business run by one person; that person has unlimited liability for any business debts.

Unlimited liability: treating the business and the individual owner as inseparable, therefore making the individual responsible for all the debts of a failed business.

End of chapter exercises

1 Why might an entrepreneur be reluctant to sell more than 50 per cent of the shares in their business?

2 Use Figure 19.1 on page 102 to calculate the percentage of businesses in England and Wales that had unlimited liability in 2020.

3 (a) Use Figure 19.1 on page 102 to calculate the percentage growth in limited companies between 2008 and 2020.

(b) Outline one possible reason for this growth in the number of companies in England and Wales.

4 Explain why it is easier to make bold business decisions if your business is a limited company than if you are a sole trader with unlimited liability.

5 K.V. Builders and Sons is an unlimited liability business that builds houses. It employs five people and borrows up to £150,000 to finance each job. Explain two reasons why it should form a company and therefore provide limited liability to its owners.

6 J.M. Medical Practice has been started by Dr Martin. She has decided to start her practice as a sole trader. Explain why she may be comfortable to run her business without the protection of limited liability.

7 In 2020 the North East was the region of the UK with the fewest businesses per thousand adults. London had the highest. What might explain the difference between the two locations?

Practice questions

New Forest Ice Cream

Enjoying New Forest Ice Cream on the beach

In 1983, three-year-old Christina Jenman asked her dad to make her some ice cream. He did, she loved it and so he started making and selling some in the family grocers' shop. Word spread and New Forest Ice Cream Ltd was born. The New Forest is an area near Bournemouth where more than 4 million tourists come each summer. Perfect for selling ice cream.

At the time, ice cream sales nationally were dominated by two companies: Wall's and Lyons Maid. Both had famous, expensively advertised brands such as Magnum – but both had a big weakness: when the sun shone in summer, big increases in demand meant that shops quickly ran out of stock. Mr Jenman made sure he had a more flexible system of production and delivery, so that booming demand could be met by booming supply.

From early on, New Forest Ice Cream achieved distribution in local shops and supermarkets, but also agreed to work with a number of ice cream vans that only sell the company's products. The need for variety forced Mr Jenman to develop new flavours and also to provide lollypops as well as ice creams. By 1990 the whole business moved to a big production unit in Lymington, and more and more staff were employed. There are still many staff who were employed in 1990 – and have stayed ever since.

The business kept growing beyond £1 million in annual turnover until in 2015, founders Mr and Mrs Jenman retired, handing over the running of the business to Christina and her twin sister Nicola. Brother Graham and cousin Dave also have important management roles. One result of the handover to the twins is a greater focus on social media as a marketing tool, such as the Facebook page with 1,400 followers. It remains the case, though, that ice cream is one of the industries least affected by recent changes in technology.

Today the business offers more than 50 ice cream flavours, with Vanilla and Salted Caramel the bestsellers. And the newly launched 500 ml tubs are selling into nationwide supermarket chains such as Waitrose. This has pushed their milk purchases up to more than £250,000 a year – all bought from local farmers.

Christina really started something.

Total: 20 marks

1 Outline one disadvantage to New Forest Ice Cream of being a private limited company. (2)

2 Analyse how New Forest Ice Cream has benefited in the long term from its limited company status. (6)

3 Next year, the company's sales revenue is expected to be £1,800,000. Fixed costs will be £600,000 and profit is forecast at £250,000 for the year. Calculate the company's total variable costs for next year. (3)

4 Christina and Nicola are considering two options to boost the company's growth in the coming year:

- Option 1: Persuade Tesco to stock New Forest's four top-selling flavours in stores throughout the UK.
- Option 2: Buy a fleet of their own ice cream vans to sell within the New Forest area.

Justify which **one** of these two options Christina and Nicola should choose. (9)

20 Franchising

When you have set up a business successfully in one location, the race is on to do the same elsewhere. If you do not 'copy' your idea, others will. Yet how can a small business quickly clone its own idea, many times over? It is hard to start up one business outlet, let alone lots of them.

One answer to this problem is **franchising**. This means selling the rights to use a business idea and methods in a specific location or area. The person or business buying the rights therefore has to do all the work to make it a success. The franchise owner must ensure they select someone who will do a good job – and therefore not damage the image of their business.

There is no better example of this than the Subway chain of sandwich shops. It was started in 1965 in the USA by 17-year-old Fred deLuca who borrowed $1,000 and set up a single outlet. Its success led him to open others, but he saw much bigger prospects, so started selling franchises in 1974. By 2016 there were 45,000 Subway outlets worldwide. The first Subway store came to the UK in 1996 and there are now more than 2,000. The chain is the UK's biggest seller of sandwiches, pushing Tesco into the number two position. In recent years, Subway has struggled in the USA due to increasing competition, but by early 2021 the number of franchise outlets in the UK had risen to 2,229.

What's in it for the franchise owner?

Expanding a business is expensive and can be difficult. Opening stores requires a large amount of capital. For example, a Burger King store typically costs £500,000. Selling franchises brings money in, instead of paying money out, and eliminates the need to employ huge numbers of managers to check up on every aspect of the store openings. The main benefits of expanding by selling franchises include:

- a firm can expand its sales quickly; this helps fill gaps that other businesses will fill if the firm does not get there first
- franchise owners not only sell a franchise, but also receive a share of all future sales. Subway (the franchise owner) receives eight per cent of the sales revenue of all 45,000 stores; in addition, every store must buy their supplies from Subway, so the central company makes profits there too
- the franchise owner can concentrate on developing new products and services, and on good marketing and advertising; this was the basis of McDonald's' huge success for many years.

Talking point

What might the advantages and disadvantages be for Tesco if they franchised out their Tesco Express (local) stores?

Starting up a franchise operation

Starting a business from scratch requires a wide range of skills. Anyone can have a bright idea; and many people are good at one particular thing – cooking, for example. Yet simply being a good cook is not enough to run a successful restaurant. You need to:

- identify a menu and an image that customers want
- work out how to run the operation efficiently
- find suitable suppliers
- market the business effectively.

It is not surprising that half of all new restaurants close within three years.

A franchise start-up takes on the brand, products and methods used by other outlets

Benefits of franchising

The key benefits of franchising (buying into a franchise) include:

- the franchise operation not only buys its part of an image (for example, McDonald's or BSM – the British School of Motoring), but also a method for doing things (for example, the equipment for making a milkshake, plus the instructions on how to make it, clean the equipment, and so on)
- an individual outlet could never afford image-building TV advertising; being part of Subway or McDonald's, for example, enables the franchise operation to benefit from major marketing campaigns
- as the products and methods of working have been pre-tested, the chance of mistakes is lower; therefore the failure rate of franchise start-ups is also lower. This means that banks are much more willing to lend to a franchise start-up than a brand new, independent operation.

> There are a lot of cowboys about.
>
> *Sir Bernard Ingham, former president of the British Franchise Association*

Being part of a franchise may enable you to benefit from major marketing campaigns

Drawbacks of franchising

Franchising is a halfway house towards running your own independent business. When buying into a franchise the buyer is bound by the rules of the franchise owner. This might be very frustrating for an experienced businessperson who wants to be their own boss. The rules may force them to offer products that sell well nationally, but not locally. Among the other possible drawbacks are:

- royalty payments (fees to the franchise owner) of as much as eight per cent of revenue are common. A typical franchise outlet might have an annual sales figure of about £300,000, so an annual

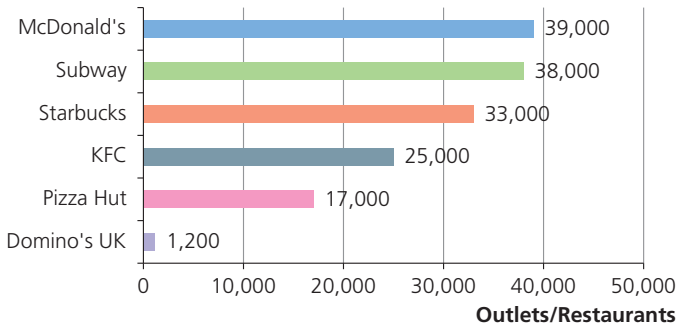


Figure 20.1 Number of outlets worldwide: major catering franchises 2021 (Sources: company websites and press releases)

payment of £24,000 is being made. That is no problem when things are going well, but in 2016 sales at US Subway outlets fell by ten per cent. Since then the number of Subway stores globally has fallen by more than 6,000. It would be very annoying to pay large **royalties** when sales and profits are falling

- not all franchises are good ones. In March 2021, the owners of the Thorntons franchise in Bridgnorth, Shropshire, spoke bitterly about an announcement to the press that 'all 61 Thorntons stores are to close' as a result of the Covid-19 pandemic. This ignored the 100 Thorntons franchise stores whose owners had risked their own capital to run their chocolate store locally.

Talking point

If you decided to start a business, would you prefer to be independent or buy into a franchise?

Drawing the right conclusions

As with any other business opportunity, buying a franchise carries major risks. The buyer needs to check the financial records of the franchise owner and talk to existing franchisees to find out whether they are happy with the service they are getting for their royalty payments. Without doubt, though, buying a good franchise is one of the best ways to start your own business. Having built up business experience running a franchise, an **entrepreneur** could try to start up a completely independent business later on.

Revision essentials

Entrepreneur: a person who sets up a business and takes on financial risks in the hope of profit.

Franchising: paying a franchise owner for the right to use an established business name, branding and business methods.

Royalties: percentage of the sales revenue to be paid to the overall franchise owner.

End of chapter exercises

1 Give two reasons why it is hard to develop a business rapidly.

2 Look at Figure 20.1 on page 107. Domino's UK is growing rapidly, but from a low base. By how many times must it increase its number of outlets to catch up with Subway?

3 Explain one advantage and one disadvantage of running a local Subway franchise compared with running an independent sandwich shop.

4 Explain why a bank might be more willing to lend money to someone opening a franchise outlet than someone opening a fully independent business.

5 Read the following extract and answer questions (a) and (b).

Ian Jones had spent ten frustrating years as a journalist, working on a shipping magazine. He had been saving for several years to start his own business. He had £45,000 in the bank and a burning desire to prove to his wife and parents that he could be a financial success. Ian loved eating out, and wanted to start a bar/restaurant. Now he had to decide whether or not to buy into a franchise operation such as Domino's, or start something completely independently. He knew that, if necessary, he could borrow up to £100,000 on the value of the house he owned jointly with his wife.

(a) Outline two reasons for and two reasons against Ian deciding to buy a franchise.

(b) Recommend whether he should buy a franchise or go independent. Explain your answer.

Practice questions

The fitness franchise

Snap Fitness is a US gym business that has been running since 2003, has 2,000 clubs and offers franchise opportunities in the UK. For a minimum investment of £160,000, you can set up your own gym. Snap Fitness boasts that it 'is dedicated to providing members with more value than any other health club and gives entrepreneurs world class support'. It makes a specific point of saying that the business can be run on a part-time basis and that break-even is achieved within six months. After complaints from new franchise owners that 18 months was more realistic, they no longer make that claim.

In 2014. Snap USA sold the rights to the UK to a 'master franchise' – a business that promised to open at least 200 Snaps by 2020. When, in 2020, only 70 new Snap gyms were open, Snap USA cancelled the agreement. Snap believes there is huge scope for faster growth in Europe generally and the UK in particular. The £160,000 minimum investment doesn't seem to hold back fitness entrepreneurs.

(20 marks)

1 Outline one way in which an investment of £160,000 might be funded. (2)

2 Discuss the difference to a new franchise business of breaking even in 18 months compared with six months. (6)

3 Evaluate the impact of risk and reward when buying a Snap Fitness franchise. You should use the information provided as well as your knowledge of business. (12)

Practice questions

Making a franchise purchase

Wayne McLanaghan first came across the OSCAR Pet Foods home delivery franchise when he was browsing the internet in search of a new business venture to take him into retirement. Wayne explains: 'On my web travels, I landed on the British Franchise Association's website and saw the OSCAR logo. I'd been buying OSCAR's food for my dog for six years, knew the local franchise owner well and understood the lifestyle he had. So I purchased a nearby franchise area.

'As an experienced business owner, I started gradually – scaling down one business, while building up the other – and concentrated on producing a business plan.

'I'd only had my boots on the ground for a year before I could see results ahead. When my local franchise owner at OSCAR retired, the opportunity to purchase his franchise became a reality. Now I'm the proud owner of a "double site" OSCAR franchise, in spite of Covid-19.'

Wayne says he's definitely had to put his thinking cap on during the pandemic. 'It helps to be adaptable and to embrace social media. It really makes a difference because visibility is vital. When it comes to customer sales, what matters most is care and support. Helping customers choose pet food wisely means their pets benefit the most and it's a joy to be part of that outcome.'

Starting from £8,995 (plus VAT), the OSCAR franchise package can be adapted to the entrepreneur's own level of expertise and skill set. Included in the fee is an educational qualification in pet nutrition and the offer of additional business development support.

Source: *What Franchise*, 22 March 2021

Total: 20 marks

1 Outline one way in which Wayne's start-up might have been helped by a clear plan for the business. (2)

2 Analyse the difference it might make for a new franchise owner like Wayne to have been a former OSCAR customer. (6)

3 Wayne seems delighted with his franchise businesses, but things can change. Evaluate the impact that the disadvantages of franchising could have on Wayne's business. You should use the information provided as well as your knowledge of business. (12)

21 Business location

Once an entrepreneur has decided a profitable opportunity exists, it is time to think about the ideal location. This is much tougher than it seems. If you buy a house, the seller only cares whether you can pay once – that is, pay the asking price. When it is business premises (a shop, say) the owner wants to know whether you'll be able to pay every month for the lifetime of the lease. That might be five to ten years.

It is also important to know that a complex trade-off exists between rental cost and value. Table 21.1 on the following page shows the amazing range of shop rents in London. Effectively, you need to sell 20 times more in Oxford Street than in Lambeth to pay for the rental cost. That's overwhelmingly likely to be value for money if your shop targets tourists; but not remotely likely if you're selling groceries.

Buildings on Oxford Street in London cost a lot of money to rent

Table 21.1 Shop rental prices in London

London shop locations	Shop size (all on ground floor)	Annual rent (as at 2021)	Cost per sq ft	Notes
Lambeth	416 sq ft	£8,500	£20	Residential area
Shoreditch	1,139 sq ft	£105,000	£92	Rents have doubled in five years; Shoreditch is trendy
High Holborn (Central London)	541 sq ft	£70,000	£129	A busy office workers' area
Brompton Road	2,921 sq ft	£550,000	£188	Quite near to Harrods
Oxford Street	1,513 sq ft	£575,000	£380	By Primark; near Tottenham Court Road tube station

Factors influencing business location

Proximity to market

One factor influencing location is nearness (**proximity**) to the market. For many businesses this is the most important factor. For a physical service such as a shop, restaurant or hotel, customer convenience will be critical to revenue. A hotel in a city centre might be able to charge £175 for a room while an identical hotel chain charges £52 on the city outskirts. As shown in Table 21.1, shop rents vary wildly depending on how convenient they are for shop customers.

Proximity to materials

For **manufacturing** businesses, nearness to materials may be more important than nearness to customers. This is especially true when the manufacturing process effectively shrinks the materials. A good example is steel making. Huge quantities of iron ore and (in many countries) coal are required to make steel. The volume of sheet steel produced is far smaller and, therefore, cheaper to transport. So, steel is made close to where the materials are mined, or close to the harbour where the supply ships arrive. Although much of the steel made in South Wales is used in car factories in the Midlands, it is more cost effective to be near the materials than near to the market.

Proximity to labour

Labour should be quite mobile, in other words able to go where the work is. If there's a job in Bristol and you live in County Durham, however, the difference in house prices (and rents) can halt the move. So, it can be sensible to locate where there are staff willing and able to work, and that have the right experience and skills. This would be particularly true for skilled work such as manufacturing construction vehicles. Locate close to the huge JCB factories in Staffordshire and you'll find people willing and able to switch to you.

Proximity to competitors

Many service businesses want a location far away from competitors – effectively being the only supplier to customers in a local area. For a corner-shop grocer or a dry cleaner, that would be perfect. For others, it is a bit more complicated. Restaurant chains such as Franco Manca find it best to be on busy high streets with lots of other restaurants, that is, competitors. This is because people meet after work, have a drink and go to places where there are plenty of restaurants to choose from; they walk down the high street and make up their minds. More isolated locations may be busy on Friday and Saturday evening, but grimly empty for the rest of the week.

> Real estate is the key cost of physical retailers. That's why there's the old saw: location, location, location.
>
> *Jeff Bezos, founder of Amazon*

Nature of the business activity

To help identify which of the four factors above matters most, it is important to think about the nature of the business activity. For manufacturers, proximity to materials may be vital, whereas physical service businesses need to be near the market – the customers.

What about businesses that have no physical connection with their customers? Online services such as ASOS and Comparethemarket.com are dealt with later in the chapter, but consider also telephone call centres (which might be in South Wales or Southern India), foreign exchange dealers and the national offices of the AA and RAC. None of these need to be near to customers or materials, and it is irrelevant whether or not they're near to competitors. Nearness to labour is therefore a factor, especially nearness to labour with the right skills and at the right price. Few would doubt that Aviva's switch of call-centre jobs from Norwich and York to India was motivated by cutting wage costs.

Other business activity issues to consider include:

- the efficiency, reliability and cost of transport links. For example, Nissan's successful car plant in Sunderland is located close to the Port of Tyne for exporting cars to Europe. For manufacturers, the quality of access to road, rail, sea and air transport are all important
- proximity (nearness) to where the entrepreneur lived and lives. This may seem a trivial point, but Innocent Drinks was headquartered in West London because that's where the three founders lived. Innocent Drinks' current owners, Coca-Cola, are still based in Atlanta, USA, 150 years after John Pemberton invented the drink there.

The impact of the internet on location

Where is ASOS based? As a customer, who cares? In fact the head office is in an arty part of North London

Primark has a very different approach to location compared to internet business ASOS

Table 21.2 The internet and location decisions

	E-commerce business, such as ASOS	High street retail business, such as Primark
Head office location	Can be anywhere	Can be anywhere
Product display	On a single website, allowing heavy investment in quality photos and customer interaction	In-store, therefore carrying high property and staff costs in multiple locations (and with too few design experts)
Stock range	Can keep every size and colour in stock, so customer disappointments should be rare	Space constraints in many store locations may mean restricted choice of colours and sizes
Customer services location	Can be anywhere; having a single location keeps costs down	In-store, therefore carrying high property and staff costs in multiple locations
Delivery to customer	Critical to have efficient deliveries; may be hard in crowded cities	Not a problem

while the main distribution depot is in Barnsley, Yorkshire. The head office location makes sense for employing fashion-focused staff who can keep the website looking great. The warehouse is close to the M1 motorway and in an old coal-mining area – good for cheap land and people in need of a job. All perfectly sensible, but quite different from the location decisions of a major retail competitor such as Primark.

The impact of the internet on location decisions between e-commerce and **fixed premises** can be seen in more detail in Table 21.2.

> E-commerce isn't the cherry on the cake. It's the new cake.
>
> *Jean-Paul Ago, CEO L'Oreal*

Making a location decision

To make a businesslike location decision, likely revenues have to be balanced against likely costs. It may seem wrong to be paying five times the rent to be at one end of the street rather than the other, but if the expensive end has the station and other busy shops, the high rent is probably money well spent.

Take the following example of two shops in the centre of Manchester, both of 950 sq ft. One is in the busy Arndale Centre, the other in relatively quiet Oldham Street. The rent in the Arndale Centre is about three times higher but should bring in double the revenue of the Oldham Street site. In this case, despite the rent being three times higher, the profit is much greater from the busier location. This will not always be the case. What is essential is that every entrepreneur should make careful estimates of revenues and costs before finally deciding on location.

Table 21.3 Revenues and costs at different locations in Manchester

	Arndale Centre, Manchester	Oldham Street, Manchester
Annual sales revenue	£600,000	£300,000
Annual rent on 950 sq ft shop	£102,000	£36,000
Other fixed costs	£56,000	£44,000
Variable costs	£360,000	£180,000
Total costs	£518,000	£260,000
Profit	£82,000	£40,000

Drawing the right conclusions

Location remains an important part of business, but e-commerce and other social factors have changed things. Pizza delivery existed before websites and apps, but e-commerce has boosted this service considerably. A pizza delivery outlet

only needs to be somewhere near people – it doesn't need an expensive high street site. But other services will always need great locations, including hotels, snack bars and coffee shops. So, landlords will probably carry on being able to charge high rents.

Talking point

In 2021, e-commerce accounted for around 25 per cent of UK shopping. What might be the effect on business location if that figure gets to 50 per cent?

Revision essentials

Fixed premises: buildings that have to be where they are (for example, the high street); e-commerce buildings can be located anywhere.

Manufacturing: turning raw materials into finished products ready for sale; usually takes place in a factory.

Proximity: nearness; whether or not a business wants to be close to a factor such as 'materials'.

End of chapter exercises

1 Explain what the text means by the trade-off 'between rental cost and value' on page 110.

2 The text covers four important location factors: proximity to customers, materials, employees and competitors. Explain which one you believe to be the most important of the four in the case of locating:

(a) an ice cream parlour, with all ice cream made on the premises

(b) a new waste landfill site.

3 Explain in your own words why it might be worth paying £380 per square foot to be located in London's Oxford Street.

4 What might be the most important four location factors for a new, online toy retailer? Briefly explain your thinking behind each factor.

5 In what way may the rents change on shop locations now that many people are ordering goods online to be delivered within an hour?

6 Table 21.3 on page 113 shows that the high-rent Arndale Centre location yields more profit than Oldham Street. But what if the annual sales revenues at Oldham Street prove to be twice as high as forecast? The effect on profit is shown in Table 21.4.

Table 21.4 Revenues and costs at different locations in Manchester

	Arndale Centre, Manchester	Oldham Street, Manchester
Annual sales revenue	£600,000	£600,000
Annual rent on 950 sq ft shop	£102,000	£36,000
Other fixed costs	£56,000	£44,000
Variable costs	£360,000	£360,000
Total costs	£518,000	£440,000
Profit	£82,000	£160,000

(a) Copy the figures for the Arndale Centre and work out its profit if sales revenue doubles to £1,200,000.

(b) Explain why the doubling of sales has such a huge effect on profit at the Arndale Centre location.

Practice questions

Square Root sourcing

Inspired by the growth of craft beer sales, in 2012 Ed Taylor and Robyn Simms started producing and selling handmade soft drinks. Rhubarb soda may not sound tempting to you, but farmers' market shoppers were keen. Seeing a serious business opportunity, in 2013 Robyn gave up her salaried job to see where Square Root sodas could be taken. Premises were found in a railway arch in Dalston – at the heart of trendy East London. Nearby were important farmers' markets plus a series of independent pubs, bars and restaurants: just the places that want to offer their customers something quirky and new.

Ed and Robyn saw their target market as adults who want a natural, tangy alternative to alcohol. Both brought a fanatical approach to sourcing ingredients direct from the farm (such as that rhubarb, brought down from Yorkshire), which helps in generating good publicity. It also helps when everything is done by hand, including hand-squeezing lemons for the lemonade.
In 2015, Square Root won the BBC's Food and Farming Award for Best Drinks Producer. By 2021, Square Root felt ready for serious expansion. It looked for £250,000 of extra capital from crowdfunding site Seedrs – and received £572,128 from supporters! By 2021 the business employed 17 people and seemed set for serious success.

Total: 15 marks

1 Analyse the probable reasons why Robyn and Ed located production in a railway arch in Dalston. (6)

2 Ed and Robyn are getting concerned about keeping up with demand. They see two options:

- Option 1: Follow the example of big competitor Fever-Tree and get an established soft drinks producer to manufacture Square Root sodas for them.
- Option 2: Rent a second railway arch and hire more staff to double the rate of production.

Justify which **one** of these options they should choose. (9)

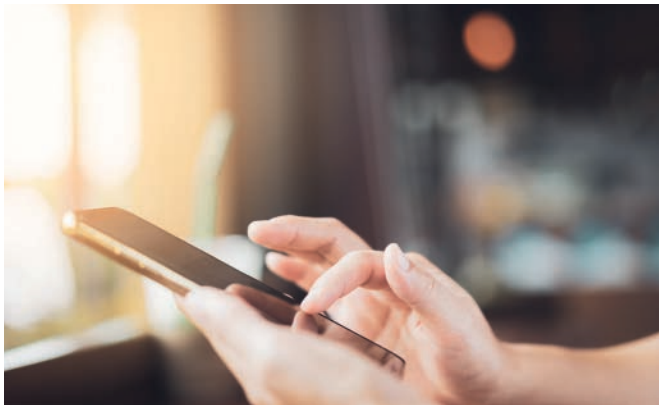
22 Marketing mix

Marketing means understanding and communicating with customers so effectively that they want to buy from you. For Apple it means designing a must-have product that fits in with modern lifestyles and enhances the customer's personal image. Therefore the customer expects – and is willing to pay – a high price for the product.

The example of Apple effectively explains the **marketing mix**. This mix is the combination of factors used by a business to persuade customers to buy. Four factors make up the marketing mix, usually referred to as the 4Ps:

- **product**
- **price**
- **promotion**
- **place.**

For Apple's iPhone, the product has to be the best-designed and most technologically advanced; the price has to be at the top-end of the market, confirming the product quality; the promotion is via classy advertising plus a lot of celebrity endorsement; and the place at which iPhones are sold (and serviced) should be as prestigious as possible (Apple shops).



The 4Ps affect all aspects of the iPhone

Product

After careful market research, a firm should be able to design a product or service that meets a specific market need. This targeting is at the heart of the mix. For example, Lindor chocolates are targeted at special occasions. Having the right luxury product to appeal to the audience is then backed up by:

- the right price – it is more expensive than other chocolates, which helps to confirm that it is worth paying for
- the right place – distributed in sweetshops and grocers, but also sold at upmarket department stores
- the right promotion – spending most of the budget on TV advertising, even in a world dominated by social media. TV shows the uniqueness of the product and creates desire for it.

> The name of the game is new products.
> *Michael Shrimi, US chocolate entrepreneur*

Price

All consumers expect value for money, so price is always important. In many cases, having a low price may be crucial to achieving high sales, for instance when selling packets of sugar or butter. At other times though, being 'cheap' may cause image problems. No one wants cheap baby food or cut-price perfume.

The ideal situation for a business is to have brands so powerful that price is not an important factor for customers. They want Nike, not just trainers; they want a Mercedes, not just a car. Consumers see both of these products as unique, and are therefore willing to pay a higher price.

Other products have to be priced in relation to others in the marketplace. Esso won't do well if it tries to price its petrol above the level of Shell or BP. Drivers buy the cheapest because they regard the different brands of petrol as the same thing.

> Cutting price is usually insanity if the competition can go as low as you can.
>
> *Michael Porter, guru to the gurus*

Promotion

This is the way a business can promote sales of its products. It lumps together methods of promoting the long-term image and sales of the business, using methods such as TV or cinema advertising, and short-term methods, such as sales promotions (for example, buy one get one free).

Most large firms are keen to use every pound spent on advertising to promote the long-term image of the product. TV and cinema advertising are especially effective at achieving this.

Talking point

What might be the key features of the marketing mix for the launch of the first ever self-driving (robotic) car?

Place

This is where (and how) the product is distributed, so that customers can get it when they want it. Mass market products usually seek as much distribution as possible. Coca-Cola uses the phrase 'an arm's length from desire'; in other words, they want such good distribution that customers should only need to stretch out an arm to get a Coke. Coca-Cola wants this (which is why there are so many vending machines) because they know that the more people see Coke, the more they buy.

For other products, the same does not apply. Chanel won't allow cut-price retailers such as Superdrug to sell its perfumes; its managers worry that cutting prices may damage the image of the brand.

Vending machines are a way to achieve large-scale distribution

Successful marketing mix

For success, a firm must make sure that its mix is co-ordinated and coherent. A stylish product aimed at a stylish market should have a high price, be promoted in stylish magazines and stocked in the most stylish shops. Similarly, a product aimed at the environmentally conscious buyer should have little advertising support, a moderate price premium and aim to be sold through a limited number of local outlets. The marketing mix puts the public face on a product or service. That face must make sense.

How the elements of the mix work together

Balancing the marketing mix based on the competitive environment

The competitive environment means the degree and closeness of competitive pressure placed on a business. For Rolls-Royce, the competitive environment is always quite calm as no other car maker in the world tries to offer a car quite like a 'roller'.

For easyJet on the other hand, the competitive environment is always tough; it is squeezed by Ryanair on price and by airlines such as Lufthansa on comfort.

Between April and June 2021, Apple saw a fall in its share of global smartphone sales. China's Xiaomi overtook it globally, helped by a volume sales increase of 86.6 per cent. This forced Apple to think hard about its marketing mix, notably its pricing policy. Fortunately for Apple, its biggest competitor in high-priced phones was Huawei – but US government sanctions had hobbled Huawei's sales. iPhone prices were left unchanged.

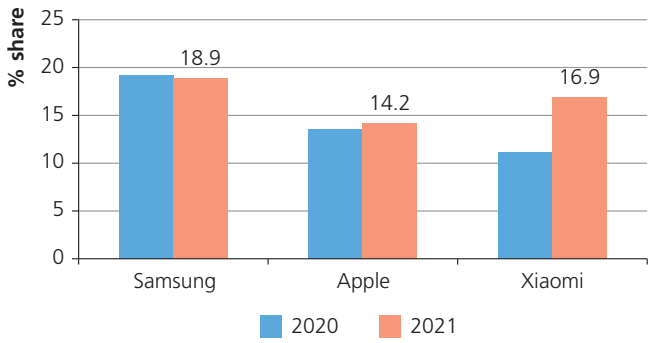


Figure 22.1 Global market share of smartphones by volume for April to June 2020 and 2021 (Source: IDC Worldwide, 14 August 2021)

Sometimes companies need to rebalance their marketing mix because of increasing competitive pressures. While Tesla focuses on pricing (seven price increases in the USA between January and July 2021), cosmetics companies such as Rimmel have been switching their promotion spending towards social media. Reports from the USA suggest that Instagram is now the most powerful medium affecting cosmetics purchasing (all those 'selfies').

The impact of changing consumer needs on the marketing mix

A long-standing consumer trend is the need for greater convenience. Once, cooked breakfasts gave way to bowls of cereal; now the bowls of cereal have given way to breakfast bars and other on-the-go food. As consumer habits change, so must the marketing mix. Packets of cereal were bought from supermarkets, so Kellogg's developed terrific distribution links to get their brand into *place*. When demand switched from Rice Krispies to Rice Krispies cereal bars, distribution changed – with sweetshops and corner shops becoming much more important.

Other important changes in consumer needs (or wants) are outlined in Table 22.1.

Table 22.1 Changes in consumer needs and wants

Change	Effect on marketing mix
Cycling switching from a leisure activity to getting to work/ daily commuting	Distribution (place) switches from bike shops in the suburbs to bike shops in city centres
The boom in UK holidaymakers going to Thailand and South East Asia	Product development, such as Heinz launching its Mayo with Sriracha Chilli in 2021
Increasing consumer demand for 'free-from' foods, such as lactose-free and gluten-free	In 2021, Alpro Almond `milk' (mainly water; only 2.3 per cent almonds) is £1.80 a litre, while dairy milk is 90p – that's bold pricing

The impact of technology on the marketing mix

In 2021, the fabled US university MIT surprised everyone with its annual list of 20 technological breakthroughs. Alongside the Covid-19 mRNA vaccine and artificial intelligence (AI) it placed the technology behind TikTok. Why? Because `TikTok's "for you" feed has changed the way people become famous online.' That, in turn, has not only made TikTok the world's most downloaded software application, it's also transformed the marketing mix. The power of influencers has become greater than conventional media promotion. The marketing mix is not disappearing, but promotion is becoming a stronger part of the mix, with the product becoming slightly more secondary.

Table 22.2 Other impacts of technology on the marketing mix

Changing technology	Effect on marketing mix
The rise of m-commerce (mobile commerce): e-commerce on-the-go via apps rather than websites	Promotional offers have to be simpler and clearer so that they can be understood quickly
Hi-tech but lighter materials have made aeroplanes much more fuel-efficient and less polluting than in the past	There's an opportunity for flight prices to be cut, especially on long-haul flights

Revision essentials

Marketing mix: the blend between product, price, promotion and place that can help a business achieve its revenue targets.

Place: how and where the supplier is going to get the product or service to the consumer; it includes selling products to retailers and getting the products displayed in prominent positions.

Price: setting the price that retailers must pay, which in turn affects the consumer price.

Product: targeting customers with a product that has the right blend of functional and aesthetic benefits without being too expensive to produce.

Promotion: within the 4Ps, promotion refers to all the methods a business uses to persuade customers to buy, for example branding, packaging, advertising to boost the long-term image of the product and short-term offers.

End of chapter exercises

1 Why is it important for a business to target a specific customer need?

2 Outline the marketing mix used by one of the following:

(a) Cadbury's Creme Eggs

(b) Tesco stores

(c) Ryanair.

3 Why might 'buy one get one free' be a poor way to boost the long-term image and sales of a brand?

4 Explain one argument for, and one against, Chanel's attempt to stop Superdrug from stocking its Chanel No. 5 perfume.

5 Why might a supermarket be reluctant to stock a new chocolate bar from a new producer?

6 (a) Outline one way consumers' needs may have changed when Covid-19 lockdowns hit the UK.

(b) Analyse how these changes might affect the marketing mix for a bakery.

Practice questions

Twinings' long-term success

In early 2005, Twinings launched an 'Everyday Tea'. Before then, Twinings had only focused on special teas, such as Earl Grey. Now it was going head-to-head with the big beasts: Tetley and PG Tips.

Twinings' marketing idea was to launch a tea with a comparable taste to Tetley and PG, but with a superior image backed by the 300-year-old Twinings brand. TV commercials featured the actor Stephen Fry, known for his good taste and his typical 'Englishness'. Twinings Everyday Tea sold at a 20 per cent price premium to Tetley and PG. The new product was promoted by £4.5 million spent on TV and radio advertising. The distribution was through supermarkets and grocers, plus restaurants and hotels.

The effectiveness of Twinings' marketing mix can be seen in Figure 22.2.

In August 2021, Twinings was still selling its Everyday Tea at a significant price premium to PG and Tetley, and Twinings overtook Tetley and PG Tips in total sales.

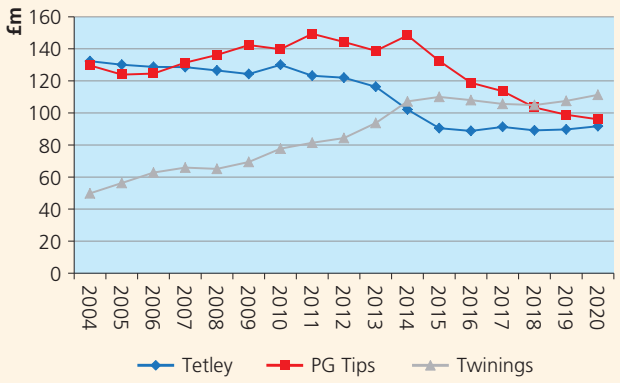


Figure 22.2 The rise of Twinings tea, 2004–20 (Source: *The Grocer*, UK market annual sales)

Table 22.3 Comparison of tea sales (prices as at 15 August 2021)

	Tesco	Sainsbury's
Twinings Everyday Tea (100 bags)	£5.00	£5.30
Tetley tea bags (80 bags)	£2.00 (with Clubcard)	£2.00
PG Tips Pyramid tea bags (80 bags)	£2.00	£2.00

Total: 20 marks

1 Define the term 'marketing mix'. (1)

2 Calculate Sainsbury's price per tea bag for Twinings and Tetley. (2)

3 Calculate the price premium Sainsbury's charges for Twinings compared with Tetley. (2)

4 Using the information in Figure 22.2, state the value of Twinings' sales of tea in 2011. (1)

5 Outline one way in which a business such as Twinings benefits from charging a price premium. (2)

6 Evaluate the impact of Twinings' marketing mix on its launch of everyday tea. You should use the information provided as well as your knowledge of business. (12)

23 Business plans

A **business plan** is a document setting out the business idea and showing how it is to be financed, marketed and put into practice. It is likely to be a crucial part of an attempt to raise finance from outside sources such as a bank.

Starting a business requires a lot of different tasks to come together in a co-ordinated way at the right time. If you are opening your first restaurant, all these tasks must be completed before your opening night: building work; decoration; kitchen equipment bought and fitted; staff hired and trained; menu chosen and printed; wines chosen, delivered and wine list printed; food supplies bought; tills and credit card-reading equipment in place. For this to work without a clear plan is asking for the impossible. A business plan is therefore essential for start-up success. Yet most entrepreneurs treat a business plan as something that banks ask for; that is, something for others, not for themselves.

> Every moment spent planning saves three or four in execution.
>
> *Crawford Greenewalt, former president of Du Pont*

The role and importance of a business plan

A good plan should be persuasive to an outside investor and useful to the entrepreneur. It should explain what makes the business special and help the entrepreneur to never lose sight of what she or he is trying to achieve. Despite this, it is clear that a business that needs capital will concentrate mainly on the outside investor. This might be a bank or a venture capital investor who buys an ownership stake in the business.

The heart of the business plan should be based around competitive advantage; this means identifying the features of your own product or service that will make it succeed against competitors. This may be based on a unique idea, a better product or service, or the power of a great brand. On the other hand, a business may decide to strip a product or service down to make it possible to be the cheapest in the market. Ryanair's competitive advantage is based on being Europe's lowest-cost airline; this allows it to charge the lowest prices, yet still make a profit.

Every business plan should contain the following sections:

1. The business idea: explain it from the customer's point of view; for example, when describing smoothies, do not say 'we'll crush fruit and put it in bottles', but 'it'll provide busy people with two portions of fruit in an enjoyable, messy-free way'. If others already offer the service, you must explain what is different about your idea.
2. Business aims and objectives: is the aim to provide something of value to society (a robot that irons clothes perhaps?) or is it just to cash in on a money-making opportunity? Some investors want their money put to good use, as well as to profitable use. The company objectives should turn the broad idea into specific, measurable goals.
3. Target market: focus on market trends rather than market size, such as whether the market is growing and, if so, how rapidly. Identify the key customers within this growing market. The more narrowly they can be defined (20–25-year-old

men, perhaps) the easier it is to target them through advertising and marketing. Hugely helpful would be good quality, independent market research with a large enough sample size for the findings to be reliable.

4 Marketing plan: how do you plan to communicate with the customers you are targeting? How expensive will this be? Within this section, there should be an explanation and justification for the prices you plan to set, plus a forecast of likely sales per month for the first two years.

5 Forecast revenue, costs and profit: together these will provide an effective way to work out the break-even point and margin of safety. The revenue forecast requires research to be used to estimate likely sales. The forecast of possible costs relies on the ability to break costs down into fixed and variable. Typically a business would be looking to reach break-even within 12–18 months.

6 Cash flow forecast: even businesses that go on to make spectacular profits may start with awful cash flow problems. This is a particular problem for businesses where customer loyalty needs to be built over time, such as seaside hotels. In the first trading year or two, a seaside hotel may struggle to bring in enough cash to cover the outgoings. So, cash needs to be forecast, planned and managed with great care. One approach that will delight a bank manager is to plan cash inflows as cautiously as possible (on the low side) while forecasting cash outflows on the high side. Then surprises should be pleasant rather than shocking.

7 Sources of finance: having forecast the cash flow on the start-up, capital needs can be thought through. The entrepreneur should want to invest as much as possible personally, in order to have maximum possible control of decision making. Beyond that, plans must be made for a balanced approach between short-term and long-term capital raising, and a mixture between share and loan capital.

8 Location: as discussed in Chapter 21, the ideal location depends on a mixture of factors, such as whether the business needs to be close to its market. A further factor is simple affordability. All the evidence may say that an expensive location will work best, but that may be unaffordable. It may be necessary to start the business in a relatively cheap location and then move when there's enough cash to do so.

9 Marketing mix. the business plan will set out the overall marketing objectives and the mix that can achieve those goals. If launching a new, classy cosmetic it may be necessary to produce a stunningly over-the-top product and box, priced relatively high, stocked in upmarket stores and advertised in classier fashion magazines.

A business plan needs to be detailed

The business plan: benefits and problems

Table 23.1 (page 123) summarises the benefits and problems an entrepreneur may encounter when writing a business plan.

The key thing to remember is that the business plan is only as good as the information it is based on. As much of this will have to be estimated or guessed, it is clear that no one should treat a business plan as a factual document. It may help steer the business in the right general direction, but it may be an exaggeration to see it as a 'sat nav'.

Table 23.2 provides advice on how to write a good business plan. This is based on various sources, including the Prince's Trust, a charity set up by Prince Charles to support young people in various ways, including becoming successful entrepreneurs.

Table 23.1 The benefits and problems of writing a business plan

Benefits	Problems
Forces the entrepreneur to think carefully about every aspect of the start-up, which should increase the chances of success	Making a forecast (e.g. of sales) doesn't make it happen; entrepreneurs sometimes confuse the plan with reality; poor sales can come as a terrible shock
May make the entrepreneur realise that she or he lacks the skills needed for part of the plan, and therefore try harder to employ an expert or buy in advice	Problems arise if the plan is too rigid; it is better to make it flexible, so that you are prepared for what to do if sales are poor (or unexpectedly high)
If the plan is well received by investors, they may compete to offer attractive terms for obtaining capital	Plans based on high sales will include lots of staff to meet the demand; risks are lower if the business starts with a low-cost/low-sales expectation
Many entrepreneurs have the whole plan in their head, not on paper; if illness or accident strikes, others will only be able to keep things going with a paper plan	Business success is often about people, not paper. An over-focus on a perfect plan may mean too little time is spent visiting suppliers or talking to shoppers

Talking point

What do you think Dwight Eisenhower, war hero and US president, meant when he said: 'Plans are nothing; planning is everything'?

The purpose of planning business activity

Research suggests that business plans make little difference to the success rate of new business start-ups, but do make a difference to later growth rates. In other words, business planning helps in achieving higher rates of growth once the start-up phase is passed.

So, it may be that constructing a business plan makes little difference to the risks involved in the start-up phase. Of course, a really good plan would identify possible threats to the new business and may identify ways of overcoming them.

Many business plans are done quite cynically – their task is to persuade a bank or an investor to put their money in, so risks are played down. The entrepreneur may then be acting on a plan that is overly optimistic, which is no help at all. Of course, without capital there can be no start-up, so getting loan capital from a bank and/or share investment from a venture capital-provider is a vital step in an overall plan. The key, then, is for the entrepreneur to treat this capital-raising as

Table 23.2 Top tips for writing a business plan

Top tips	Detail
Be brief	Possible investors need to understand your business idea from a quick look at your plan. Start with a summary that identifies how you will make money and what the long-term potential is. Write clearly and simply.
Be precise	Being precise/specific is as important as being concise. The details will help the reader understand how you will turn an idea into a profitable enterprise.
Know the market	Explain how well you know the market you're targeting. This may be through your own direct knowledge or from market research. Which customer groups will you be aiming at? And how will your plans distinguish you from the competition?
Plan your finances	Show exactly how you will manage the three key parts of your finances: managing cash flow, achieving profits and raising enough capital to cope with the tricky early stages of starting a business. This will be vital for getting investment, but also to help in the day-to-day running of the business itself.

simply a step forward rather than an achievement in itself. Good business requires a profit, not simply the cash that has come in from investors.

Drawing the right conclusions

In order to start a great new business an entrepreneur needs to have a good idea based on a strong understanding of the customer and the competition. Then the entrepreneur needs to have the personal qualities to build effective relationships with suppliers, retail buyers and staff. If drawing up a business plan helps in that process, that's fine. The worry is that if entrepreneurs bury their heads in paper plans, it may divert them from the important tasks associated with starting a new business. A business plan can help to get investment from outsiders and may help a disorganised entrepreneur to make fewer mistakes, but it is no substitute for having strong enterprise skills.

Revision essentials

Business plan: a detailed document setting out the marketing and financial thinking behind a proposed new business.

End of chapter exercises

1 Explain in your own words the meaning of the term 'business plan'.

2 Why may young entrepreneurs need a business plan more than middle-aged ones? Briefly explain your answer.

3 Some people think that a business plan aimed at investors should be different from one aimed at bankers. Outline two ways in which a plan aimed at investors may be different from one aimed at a banker.

4 Why may an entrepreneur find it easier to write a business plan for a second business start-up than for their first?

5 If you were to open your own business after leaving school, do you think you would complete a business plan? Explain your answer with reference to your own strengths and weaknesses.

6 Read the following extract and answer questions (a) and (b).

When Sharon Shearer left school at 16, she went to work in a small bathroom showroom. She really enjoyed it and ended up working there for 26 years. Yet when her boss fell ill, the showroom closed, leaving Sharon redundant. She found work in another company for bathroom fitting, but didn't like the way the business was run or how service was provided. This gave her the push to set up on her own. She approached a bank and spoke with a business manager, who looked at her business plan and cash flow projections, and told her what she needed to do to refine her ideas. Currently, Sharon has a 1,500 square foot showroom for Superior Bathrooms in Hamilton, Scotland. Over the years, she has designed over 8,000 bathrooms. In the future, she plans to grow by setting up an online store.

(a) Explain how Sharon's business plan may have helped the bank's business manager to give her some worthwhile advice.

(b) Why might the bank have been keener to lend to Sharon after seeing her business plan?

Practice questions

Foodmaker making millions

In 2009, Kirsty Henshaw realised that her four-year-old son Toby had some serious food allergies. She bought a £30 foodmixer and devised a recipe for dairy-, sugar- and gluten-free ice cream. Friends and neighbours loved it as much as Toby. Using £2,500 saved from a student loan she launched Coconice, a range of allergen-free, healthy desserts. The following year, she gained a £65,000 investment from Peter Jones and Duncan Bannatyne on *Dragons' Den*. They took 30 per cent of the shares in her private limited company but helped her get supermarket distribution in Waitrose, Ocado and Sainsbury's.

Taking the advice of her dragons, Kirsty renamed the business Kirsty's and branched out into allergen-free ready meals. In 2015, sales of £3.6 million yielded a profit of £72,000. Kirsty then moved into the `free-from' pizza market, with great success. In 2020, with sales up to £11 million a year, she was able to buy out her dragon investors. They will have made a huge percentage profit. Also in 2020, Kirsty invested £2 million in the company's first factory. Before, they sub-contracted production to other food producers. Although she didn't have a business plan in the early days, she now keeps one up to date, finding it a helpful way to co-ordinate the company's growth.

Total: 18 marks

1 Outline one benefit to Kirsty of having her business set up as a private limited company. (2)

2 **(a)** Calculate Kirsty's 2015 profit as a percentage of her sales revenue. (2)

(b) Outline one way in which she might be able to boost that profit percentage in the future. (2)

3 Evaluate the possible reasons why Kirsty was able to start her business successfully despite having no business plan. You should use the information provided as well as your knowledge of business. (12)

Exam-style questions on Topic 1.4

Don't rush; check your answers carefully.

1 Which **one** of the following is a disadvantage of buying into a retail franchise operation? (1)

- **(a)** The brand name will already be known to many customers.
- **(b)** There will be training available on how to use the electronic tills.
- **(c)** You won't be able to form a private limited company.
- **(d)** A fee of perhaps five per cent of revenue can strip away most of the profit.

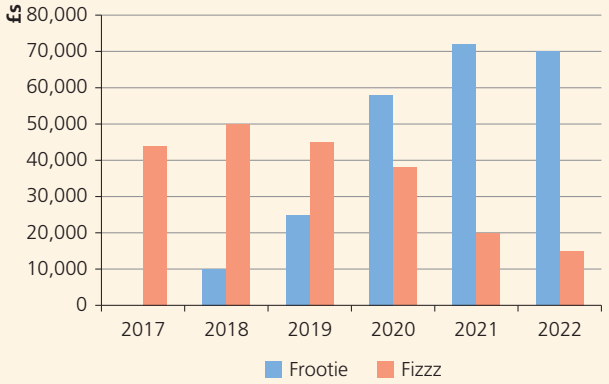
2 Which **two** factors should be most important when choosing a location for a new nail bar? (2)

- **(a)** Close to the source of the materials you'll be using.
- **(b)** Close to where your website is being hosted.
- **(c)** Close to where your target customers live or work.
- **(d)** Easy for you to get to every day.
- **(e)** Quite a distance from any other nail bars.

3 Which **one** of the following is the best definition of unlimited liability? (1)

- **(a)** Provides the entrepreneur with a limitless opportunity to make high profits.
- **(b)** Ensures that, if things go wrong, the owners can only lose the money they invested.
- **(c)** It is the method used by the majority of businesses in Britain.
- **(d)** The business owners can be held responsible personally for any debts of the business.

Questions 4 and 5 are based on the following chart, which shows sales data for Dave's Drinks Ltd.



Sales data for Dave's Drinks Ltd, 2017–22

4 Which **two** of the following are correct statements about sales at Dave's Drinks? (2)

- **(a)** Total sales in 2019 were £10,000 higher than in 2018.
- **(b)** Frootie outsold Fizzz by £70,000 in 2022.
- **(c)** Fizzz sales in 2021 were £20,000 down on the 2020 figure.
- **(d)** Total sales in 2022 were £85,000.
- **(e)** Frootie sales in 2022 were £35,000 higher than in 2019.

5 The boss of Dave's Drinks wants to put £50,000 behind advertising either Frootie or Fizzz in 2023. Which **one** of the following provides the strongest business argument? (1)

- **(a)** It should be Fizzz because without advertising the product will die.
- **(b)** It should be Frootie because its sales are higher.
- **(c)** It should be Frootie because it makes a higher profit per pound of sales than Fizzz.
- **(d)** It should be Frootie because the brand was Dave's own idea.

6 Which **one** of the following is an advantage of operating a new business as a private limited company? (1)

(a) Administration and accounting costs are lower than with a sole trader business.

(b) It's easier to bring in new investment capital than with a sole trader business.

(c) Suppliers are keener to supply a limited company than a sole trader.

(d) Banks prefer lending to limited companies than to sole traders.

7 Which **one** of the following is the best definition of the marketing mix? (1)

(a) The 4Ps that show how to make a new product a success.

(b) Combining four factors to make the marketing objectives happen.

(c) The four main factors in marketing: price, promotion, packaging and place.

(d) The mix of factors to turn a marketing idea into a marketing plan.

8 Which **one** of the following is a reason that a business plan might hold a new business back? (1)

(a) It may encourage the entrepreneur to stick rigidly to the plan and not respond to market changes.

(b) It may prevent the business from negotiating the best terms with suppliers.

(c) It may make customers reluctant to buy from a business with such rigid ideas.

(d) It may add to the start-up costs, making it impossible to break even.

Now try this discussion question.

9 Discuss the value to a first-time entrepreneur of buying into a franchise instead of starting up independently. (6)

24 Stakeholders

Stakeholders are the people or groups with an interest in the success or failure of an organisation. Some work inside the business and some outside, and all are likely to have slightly different objectives. Shareholders and staff, for example, may want very different things from the business.

Among the main stakeholders in business are:

- the owners/shareholders
- the staff/managers
- the customers
- local residents, who may be affected by traffic noise from deliveries or by pollution from a smelly or smoky factory or farm
- local government, which is the organisation that will give a yes or no to future planning permission, for example on whether the business is allowed to build a larger warehouse
- **pressure groups**, for example Greenpeace, who may organise protests if they feel that an organisation's activities damage the environment.

Pressure groups may be regarded as stakeholders in a business

Stakeholders and their objectives

Fruit drinks brand Flawsome! started up recently, keen to make use of wonky ('flawed') fruit. At Flawsome!, fruit that's rejected by supermarkets is turned into fizzy strawberry or fizzy cherry soft drinks. Co-founder Karina Sudenyte wanted to start a business with a zero carbon footprint. Taking fruit that would otherwise be thrown away was a perfect way to do this. The original objectives for Flawsome! were social, focusing on customers and society rather than shareholders.

To develop this idea further Karina made sure that the recipes require no added sugar; the wonky fruit have the flavours required to create a refreshing drink. When she launched her range of Flawsome! sparkling drinks she announced to the press that: 'We hope our refreshing drinks will make people think about waste in a new way and encourage a more sustainable attitude to their consumption of fruit and veg.'

While Flawsome! focuses on social goals, other companies take a different view. Britain's high street banks in particular have shown a consistent tendency to prioritise profit over the best interests of their customers.

Staff, customers and shareholders are not the only stakeholders a business may have to consider. The owner of a good restaurant will consider suppliers to be very important. They may buy steak from a local farmer who produces tender, organic meat. The restaurant's reputation depends on the quality of the farmer's deliveries. Therefore the supplier becomes a key stakeholder.

Table 24.1 Different stakeholders and their objectives

Stakeholder	Different objectives of each stakeholder group
Shareholders (owners)	Shareholders in family-run, private limited companies usually focus on long-term organic growth. Shareholders in public limited companies (plcs) are more likely to care mainly about the short-term share price – they may be delighted to sell at a big profit if the company is bought by a rival, or to see sharp cost-cutting to boost profits
Employees	Security of employment; opportunities for career development (so organic growth is a key objective); fair pay and good 'fringe benefits' such as pensions, holidays and perhaps a company car
Customers	Consistently high-quality products and service; honest and fair dealing from the company; bright, innovative new products that make life better (or more fun)
Managers	Security of employment; opportunities for career development (so organic growth is a key objective); fair pay and good 'fringe benefits' such as pensions, holidays and perhaps a company car
Suppliers	Honest and fair dealing from the company, especially on prices and credit terms; good communication about future plans; strong organic growth meaning rising demand for supplies
Local community	Honest and fair dealing from the company, especially on plans that affect local employment and the environment; some locals may want to see the business grow, others may not
Pressure groups	Honest and fair dealing from the company, especially on plans that affect customers and the environment; often pressure groups seem to be against growth, perhaps focusing overly on the downside of business activity
The government	Honest and fair dealing from the company, especially on tax arrangements, employment plans and location plans (HSBC threatened to leave the UK to try to water down legislation controlling banking practices; it succeeded)

Table 24.1 sets out the different objectives of the various stakeholder groups.

Talking point

Consider which Samsung stakeholders might have agreed with each other when the company launched the (unintentionally!) exploding Note 7 smartphone.

Small business stakeholders

For most small firms, the keys to success are customers, staff and suppliers. Treating them well is essential, partly because you never know when you may need them to help you. A really committed restaurant supplier would drop everything and rush to a client that had run out of chicken half way through the evening. A really committed customer may help out when needed (for example, paying in cash to help a supplier with cash flow problems). Most important of all are the staff, because if they are well motivated, their enthusiasm will rub off on to customers and suppliers.

Are shareholders number one?

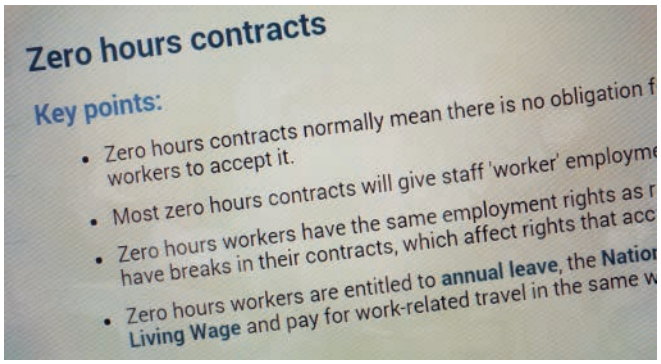
The directors of most public limited companies have little choice but to treat shareholders as the most important stakeholder. This is because the shareholders have the right to vote the directors out of office if they believe that the business is being run badly. Some companies are open about the priority given to profit and, therefore, shareholder returns. Others prefer to suggest that they treat all stakeholders equally.

The record of companies such as Volkswagen (cheating on exhaust emissions), GlaxoSmithKline (bribing doctors) and those involved with the collapse of Arcadia and Carillion suggest that shareholder profits remain the priority for most.

> A lost job can put the smile on any shareholder's face.
>
> *Eric Reguly, Canadian journalist*

How stakeholders are affected by business activity

In the UK, manufacturing generates just under ten per cent of all economic activity. Our economy is dominated by services, from retailing through music to banking. So the main effects of business on stakeholders relate to the service sector; in other words, few people are affected by industrial pollution. Far more serious is the pollution of the body (and the mind) caused by over-processed foods, by the casual prejudice based on race or gender shown by certain newspapers and their online sites, and by the treatment of staff trapped in low-wage, insecure, zero-hour jobs in businesses such as Sports Direct and Amazon.


Zero hours contracts
Key points:
• Zero hours contracts normally mean there is no obligation f
workers to accept it.
• Most zero hours contracts will give staff 'worker' employme
• Zero hours workers have the same employment rights as r
have breaks in their contracts, which affect rights that acc
• Zero hours workers are entitled to annual leave, the Natio
Living Wage and pay for work-related travel in the same w

Zero hour contracts affect business activity

It is important to also recognise the fantastic good done by many businesses, such as:

- activities for small children and their parents, which bring people together
- specialist restaurants that give people a taste of home or the chance to eat out in a way that suits their diet/lifestyle
- shops that focus on organic meat and other produce, giving an outlet to suppliers who might otherwise struggle to run their own businesses.

In other words, the impact of business on stakeholders can be beneficial as well as damaging.

Talking point

Why might a lost job 'put the smile on any shareholder's face'?

How stakeholders impact business activity

The effect of stakeholders on businesses has become a major concern for all companies that operate in the public eye. Big companies have whole departments devoted to the management of their image and their relationships with outside groups. This process covers social media management (or even manipulation) and careful management of contacts with the press. In recent years, Philip Green received awful publicity about the collapse of the BHS and Arcadia store chains, but for many years before that he'd had praise heaped upon him by the press.

Occasionally, though, stakeholders have an impact on business activity. After the ghastly Rana Plaza disaster killed more than 1,100 clothing workers in Bangladesh in 2013, media and pressure group activity forced clothing retailers to be more careful about where they bought supplies from.

Possible conflicts between stakeholder groups

Some conflicts between stakeholder groups are inevitable. When Morrisons supermarkets were bought for £10 billion in 2021, its shareholders enjoyed a 40 per cent profit overnight. For Morrisons staff and UK suppliers the takeover was disappointing, even worrying. But the shareholders accepted the bid and took their profit.

Examples of other potential conflicts between stakeholder groups:

- A supermarket's shareholders, managers and employees are happy to launch a new range of luxury sandwiches; a pressure group later reveals that each sandwich contains more fat and calories than a Big Mac and chips. Customers are shocked (but perhaps keep eating).
- Managers keep their regular salaries, fringe benefits and secure jobs, but push various 'worker' jobs on to contractors that employ staff on short-dated contracts at low wages and with no sick pay or pensions. Shareholders may feel happy with this arrangement until, years later, they find how poorly these jobs are done.

> The way you treat your employees is the way they will treat your customers.
>
> *Richard Branson, founder, Virgin Group*

Drawing the right conclusions

Companies need to think about their public image. It is, therefore, important for managers to think about their wider responsibilities. If they fail to do so, the result might be bad press or a social media storm, with local residents or national pressure groups making complaints. Nike has suffered bad press in the past from the use of low-cost (even child) labour in making its (very expensive) trainers. Pressure groups (and customers) blamed Nike for ignoring its responsibility to its suppliers.

The issue of stakeholders simply urges firms to think more widely about the effects of their business activities. Well-managed firms have always done this. The risk today is that every firm claims to care about its stakeholders, whereas day-to-day business decisions continue to make profit the top priority.

Revision essentials

Pressure group: an organisation formed to put forward a particular viewpoint, such as promoting organic farming.

Stakeholders: all those groups with an interest in the success or failure of a business.

End of chapter exercises

1 What is the difference between a shareholder and a stakeholder?

2 Which three stakeholder groups do you think are the most important for:

(a) your school/college

(b) your nearest sweetshop or grocers?

3 Outline two possible disadvantages for staff who work for a business that only focuses on the needs of shareholders, not stakeholders.

4 Read the following extract and answer questions (a) and (b).

In July 2021, the *Daily Mail* reported on the purchase of a six-bedroom country manor house. The purchaser was a pub landlord friend of Matt Hancock, the government's Health Secretary during much of the Covid-19 crisis. Hancock had helped his friend get fast-track status for his company Hinpack Ltd to supply PPE (personal protective equipment). Even though the business was tiny (just two staff) and had no experience in healthcare, Hinpack received a £30 million contract. The house purchase suggests it was a very profitable one.

(a) What does this case imply about the company's stakeholder priorities during the pandemic?

(b) Should private companies such as Hinpack Ltd be required to state how they are looking after their main stakeholders? Briefly explain your answer.

5 Read the following extract and answer questions (a) and (b).

In 2020, online fashion retailer Boohoo appointed an independent legal adviser to look into reports of awful working conditions in its UK supplier factories. The review found failures in the recording of staff hours and the payment of wages, plus health and safety violations. It quoted a factory inspector stating that one factory making clothes for Boohoo had 'the worst working conditions that I have seen in the UK'.

The legal adviser, Ms Levitt, added that Boohoo's oversight of its supply chain had been 'inadequate for many years' and that internal processes were 'well below the standard which would be expected of a company of its size and status'. The report found that a full list of suppliers and subcontractors did not exist, while the company's monitoring presence in Leicester largely consisted of one person.

When the report was published, observers were surprised to see that the price of Boohoo shares rose by 15 per cent, adding nearly £600 million to the value of the company. City analysts realised that the report's recommendations would have little effect on future profits.

Some months later, Boohoo released its profits for the period in which media reports had been highly critical of Boohoo. Revenues were up by 45 per cent and profits by 51 per cent. It seemed that as long as the clothes were cheap enough, customers didn't really care about the treatment of the UK workers making the garments.

(a) Examine the signals coming from Boohoo's stakeholders on the proper priorities for the business.

(b) Why might the company benefit in the long term by making greater efforts to get its suppliers to treat workers with respect and fairness?

6 Qatar Airways has just cancelled an order for the Airbus A320 plane because of delivery delays. Airbus, in turn, blames the US engine-maker Pratt & Whitney, who have had delivery hold-ups. The cancellation threatens jobs at Airbus' French and British production centres.

Which three stakeholders in Airbus have been identified in this passage of text?

(a) Local residents

(b) Shareholders

(c) The government

(d) Staff

(e) Customers

(f) Suppliers

Practice questions

Painful mistakes

Giant multinational Reckitt Benckiser had an interesting start to 2016. In April the company was fined nearly A$1.7 million after an Australian court criticised its misleading way of marketing Nurofen. The packaging suggests that 'Nurofen Back Pain' offers 'fast targeted relief' specifically for back pain, but in fact it is just the same as any other Nurofen.

More importantly, in May the head of Reckitt Benckiser Korea was forced to apologise for the deaths of 92 customers whose lung injuries were caused by a product sold only in South Korea. He also apologised for the company's repeated denials of wrongdoing as they kept selling the product for years after the problem came to light: 'We were late. Five years have passed.' On 29 July 2016, Reckitt announced a £300 million charge on their profits to cover possible fines and compensation to be paid in South Korea.

The news was happier for Reckitt's chief executive, Rakesh Kapoor, who received a £23 million pay package. Shareholders objected noisily to such a huge pay award, but the pay package was approved.

Total: 15 marks

1 Analyse which stakeholder groups Reckitt Benckiser seems to have been prioritising in recent years. (6)

The makers of Nurofen were fined by an Australian court for misleading marketing

2 Rakesh Kapoor is thinking about how best to rebuild Reckitt Benckiser's reputation in South Korea. He sees two options:

- Option 1: Turn Reckitt Benckiser Korea into an employee co-operative along the lines of John Lewis/Waitrose.
- Option 2: Sack the existing senior management team in Korea and replace them with UK managers who had nothing to do with the lung injury scandal.

Justify which **one** of these options he should choose. (9)

25 Technology and business

Technology affects business through products and process. Products are what the customer buys, from smartphones to streaming services such as Netflix. Process is the technology used by the business to make itself more efficient and effective, such as GPS to map the best route to deliver five items to different parts of the city.

Modern developments in digital technology can be attributed to what has become known as 'Moore's Law'. Gordon Moore, former boss of chipmaker Intel, suggested in 1965 that technical development enabled the computing power of a microchip to double every two years. Remarkably, that 'law' proved good for the next 50 years, allowing computing power to grow at a staggering rate.

Despite the amazing progress in digital technology, western economies have seen productivity (efficiency) slow down rather than speed up. That, in turn, has slowed the pace of economic growth. As shown in Figure 25.1, growth has slowed generally. Even the USA, home to so many digital innovations, saw its growth rate slip.

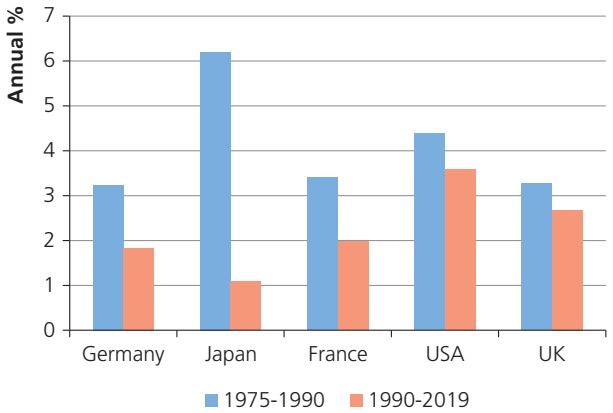


Figure 25.1 Average annual growth in GDP per capita (Source: OECD Statistics)

> When consumers adopt new technologies, they do old things in new ways. When they internalize technology, they begin to do new things.
>
> *James McQuivey, business author*

Types of technology used in business

E-commerce

E-commerce means selling online rather than in a physical one-to-one transaction. This might be done through a PC/laptop via a website or, more commonly, through a smartphone via an app. This mobile form of e-commerce can be called m-commerce. Figure 25.2 shows that between 2013 and 2020 the proportion of Domino's orders placed online nearly doubled to 90.5 per cent. This helped stimulate Domino's huge rise in sales over this period.

For other businesses though, e-commerce may be a relatively minor issue, or even an irrelevant one. In June 2021, US airline United Airlines ordered 270

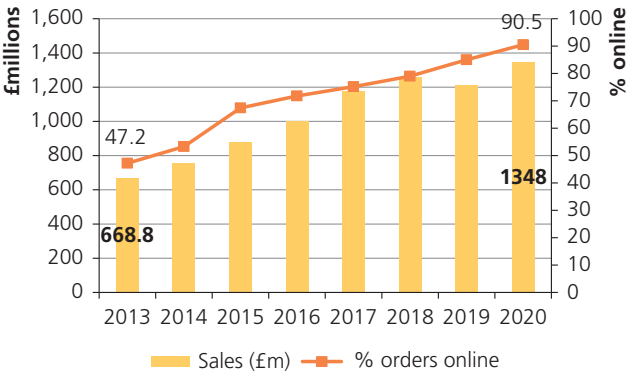


Figure 25.2 Growth of e-commerce at Domino's Pizza (Source: Domino's annual reports)

aircraft from Europe's Airbus and the USA's Boeing manufacturers. The orders were worth $30 billion at list price. Inevitably, no one is going to make such a purchase through e-commerce. There will be fierce negotiations on price and detailed discussions will be needed on how the interior of the aircraft will be fitted out. E-commerce will never have a significant part to play in this kind of big business activity.

> In e-commerce your prices have to be better because the consumer has to take a leap of faith in your product.
>
> *Ashton Kutcher, actor and investor*

Social media

Social media such as Facebook, Instagram and TikTok are used by businesses for two-way communication with customers. In recent years, Domino's Pizza's 'digital engagement' efforts included:

- heavy investment in a 'zero-click' app, rated highly on the basis of 300,000 reviews
- collaboration with vloggers/Twitter users to 'engage in a natural way' with customers
- direct expenditure on a Snapchat area for users to record and share pizza videos.

Some businesses believe that consumers are relatively unaware that many bloggers are in effect paid to advertise and promote certain products. In traditional media, advertisements were clearly separated from editorial; in social media the lines are more blurred. It could be said that this is against the consumer's best interests as it overly favours businesses.

Digital communication

Digital communication may seem to revolve around social media, but it is important to remember email as an outstanding and cheap means of achieving one-to-one conversation. A customer sends in a query, which can be answered specifically and personally – as long as the company is set up to do this. The risk is that the query gets directed to an outsourced call centre where a generalised answer is given by a non-expert. Many companies have even outsourced 'customer service' to low-wage countries overseas. In this way, they are using technology to cut costs instead of raising the speed and quality of the service. Many companies have found, however, that the loss in customer confidence outweighs any benefit from lower costs.

Talking point

Do you think there will come a time when no one uses cash anymore? How do you feel about that?

Table 25.1 Advantages and disadvantages of e-commerce

Advantages of e-commerce	Disadvantages of e-commerce
Enables a small business to start up from a back bedroom, testing the market before spending a lot on offices and staff	In many sectors, winner takes all (e.g. Amazon in book sales). Dominant (monopoly) businesses rarely serve customers well in the long term
Enables a small business to sell to the world without needing an expensive overseas sales and distribution set-up	Dubious environmentally as there are large numbers of van deliveries and returns ('wrong size', 'not sure I like it'); this is surely a carbon-loaded way of trading
Provides scalability – that is, you can finance faster growth than is true of old-style retail or service businesses	For first-movers, websites and apps work well, but it is very difficult for late-arrival competitors to make themselves seen and heard by the market – and creates issues regarding monopoly
Use of social media makes it possible to build a relationship with customers even though you do not meet them physically	Some customers effectively blackmail businesses (e.g. 'give me a free bottle of wine or I'll give you a bad write-up on Twitter/Tripadvisor)

Payment systems

Payment systems such as PayPal and Stripe are at the heart of all e-commerce. Before PayPal was established, people were concerned about the security of their money when using e-commerce. With PayPal the level of security improved dramatically, giving people the confidence to spend more freely online. Other electronic payment systems include:

- Electronic Funds Transfer – this is a method by which payments can be settled and bills paid online.
- M-Pesa – this mobile banking system began in Kenya and was the innovator in offering a full banking service over the phone ('M' stands for mobile and 'Pesa' is Swahili for money).

How technology influences business activity

Technology affects every aspect of business management, but there are three areas of special focus: sales, costs and the marketing mix.

Sales

Sales are affected by product and by process. In certain sectors, technology is the driving force behind customer behaviour. Figure 25.3 shows worldwide sales of Sony's PS5 games console versus Xbox X|S since their launch in November 2020.

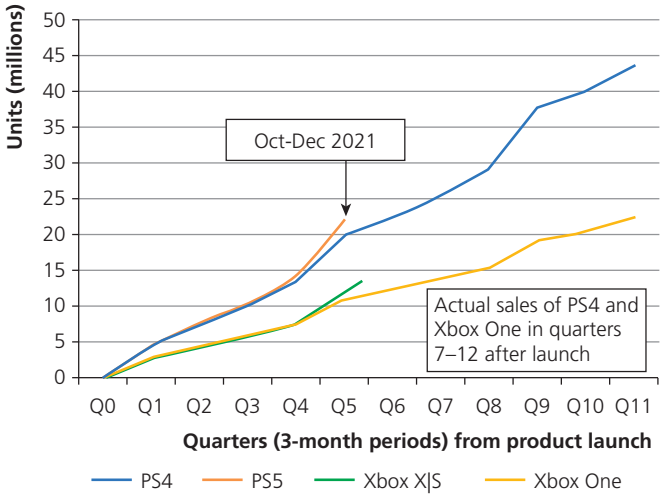


Figure 25.3 Global sales of games console hardware (Sources: various, including Sony accounts)

The graph also shows the initial sales of previous consoles, PS4 and Xbox One, to give a comparison. The impressive new technology of the PS5 has allowed Sony to far outstrip sales of the PS4 and, of course, rival Microsoft's Xbox X|S.

Technology can also affect the sales of items such as kebabs. The UK firm Just Eat has enabled small, independent fast-food outlets such as kebab shops to make sales online. Without this possibility, Domino's Pizza would have gained an even larger share of the fast-food delivery market. In this case, technology has improved the process rather than the product.

Costs

Costs need to be split into fixed and variable. Technology has an impact on each of these. An important fixed cost is advertising. Traditional media advertising using TV, for example, had the disadvantage of being ill-focused. Saga Holidays will use TV in the afternoon to target retired people, but there will still be some younger people watching. So to achieve a £2 million advertising hit on older people, they might need to spend £4 million. Digital technology changes that by targeting individuals. The advertisers gather data on your choices and habits which means that a teenager doing a Google search will never be targeted with a Saga Holiday. Less of the advertiser's money is wasted, allowing a cutback in advertising spending and therefore cutting fixed costs.

With variable costs such as raw materials, the huge benefit from technology is to make it easier to quickly find out the prices charged by different suppliers. This makes it easier to find the lowest costs, thus cutting variable costs.

Marketing mix

Technology affects the 4Ps in different ways for different businesses. As mentioned above, there is a tendency for price competition to become greater because people know all the available product prices. It took three minutes to find out the price comparison of TVs shown in Table 25.2 on the next page.

Table 25.2 Price comparison of a TV set (August 2021)

	Currys	Argos	John Lewis
Samsung 50 inch LED TV	£549	£479	£479

This means that companies have to treat their pricing decisions as more important than they might have done previously.

Other mix factors are also affected by technology:

- Product – improved technology can enable a product to gain market share.
- Promotion – digital marketing can improve the effectiveness of marketing spending, allowing the cost to fall.
- Place – in many cases today, 'place' changes from being a physical location such as a shop, and becomes a digital exercise conducted online.

Drawing the right conclusions

Technology changes constantly, but not always significantly. Baked beans are mass-produced today in much the same way as 30 years ago. What is certain, though, is that being one technological step ahead of competitors is always a great place to be. A business can potentially charge customers more while facing lower production costs. This enables the business to be much more profitable.

Revision essentials

Digital communication: messages or conversations conducted via email, text or social media.

E-commerce: selling online rather than in a physical one-to-one transaction. An important part of e-commerce is m-commerce, meaning commerce using apps/smartphones rather than websites/PCs.

Payment systems: ways of paying electronically such as PayPal.

Social media: interactive channels of communication, via words, photos or videos, such as blogs, Facebook and Instagram.

End of chapter exercises

1 Moore's Law still seems to work 50 years on. Why might that be important to a business such as Sainsbury's?

2 As of the second half of 2021, Primark still had no plans to move towards e-commerce. Is the clothing retailer making a mistake?

3 **(a)** Look back at Figure 25.2 on page 134. Calculate Domino's actual sales online (in pounds) in 2013 and again in 2020. Then calculate the percentage increase between 2013 and 2020.

(b) In 2020, with much of the year under Covid-19 lockdowns, Domino's sales boomed. Outline one possible explanation for that.

4 Look back at Figure 25.3 on page 136. Explain two possible reasons why PS5 is outselling the Xbox X|S.

5 In 2021, 66 per cent of UK over-13s used Facebook. Among the age group 13–16, an even higher percentage used TikTok. Would Facebook or TikTok be better for promoting the following?

(a) Holidays on cruise ships.

(b) A new skateboard park.

Briefly explain your thinking.

Practice questions

Just deliver

In 2012, Will Shu was transferred from New York to the London offices of Morgan Stanley. He quickly noticed that although it was easy to get ordinary takeaway food delivered, London lacked New York's delivery options from better restaurants. After six months' research, in 2013 he founded Deliveroo. Whereas Just Eat simply links the customer to a fast-food restaurant, Deliveroo actually carries out the deliveries. Also, Deliveroo's links are to restaurants rather than pizza takeaways and kebab shops. Such was the success of Just Eat that Will had no problems in raising $100 million of capital to start his business. A further $100 million was raised in November 2015 to fund Deliveroo's expansion. Huge growth thereafter led to the company becoming the biggest flotation for a decade when it launched on to the London Stock Exchange in March 2021. Deliveroo's float was unusual because although Will Shu was left owning just 6.3 per cent of the shares in 'his' company, special arrangements gave him 62.5 per cent of the voting rights. So he was still in control.

In practical terms, the heart of the business is technology. The Deliveroo app is slick and effective and the company had already built a huge presence in the UK and Europe even before the pandemic. With home delivery booming, Deliveroo was delivering from over 110,000 restaurants by mid-2021. Sales in January–June 2021 were £922.5 million, up by 82 per cent on 2020. On 17 August 2021, the stock market valued the company at £7.04 billion.

Total: 20 marks

1 State one difference between Deliveroo and Just Eat. (1)

2 Analyse the necessary qualities of an app to make an online delivery business stand out from the competition. (6)

3 **(a)** Calculate the 17 August 2021 value of the shares owned by Will Shu. (2)

(b) Outline why Deliveroo's shareholders may not mind that Will Shu has kept 62.5 per cent of the voting rights in the company. (2)

4 Deliveroo wants to create a far stronger social media presence than Just Eat. Will Shu sees two options:

- Option 1: Make a series of links with celebrities providing free food and other incentives linked to tweets and other favourable mentions of Deliveroo online.
- Option 2: Hire a social media advertising agency to create fun viral video clips of Deliveroo, its customers and its delivery riders.

Justify which **one** of these options he should choose. (9)

26 Legislation and business

In December 2015, the owners of the Real China restaurant in Eastleigh, Hampshire, were fined £70,000. This was because 100 diners had been hospitalised from salmonella food poisoning. Food Inspectors found 'rotting meat in a sink' and other 'totally unacceptable' practices. The owners were prosecuted under EU laws relating to food safety and hygiene. Such things happen but, happily, very rarely in the UK. The **legislation** protecting consumers in the UK is among the tightest in the world. In August 2018 the 100 diners shared a compensation payout worth £250,000.

The purpose of legislation

Principles of consumer law

Consumer law is passed by Parliament to try to protect consumers from:

- harm caused when the supplier knows more than the consumer, for example in the decades when the tobacco industry knew more about the harm done by cigarettes than their customers
- harm caused when the consumer is lied to or misled, for example in the days before the 1968 Trade Descriptions Act, when Guinness beer claimed to be 'good for you', or the dog food PAL claimed to 'Prolong Active Life'
- exposure to unsafe or unhealthy foods or other products, as in the case of Real China.

Consumer protection legislation

There are two especially important pieces of consumer protection legislation: the Consumer Rights Act 2015 and the Trade Descriptions Act 1968.

Before the Trade Descriptions Act, Guinness claimed: 'Guinness is good for you'

> Good people do not need laws to tell them to act responsibly, while bad people will find a way around the laws.
>
> *Plato (428–348BC)*

Consumer Rights Act 2015

This law was passed in 1893 and was one of the world's earliest examples of legislation to protect consumers. It has been updated many times since then, including in 2015 when it was updated to incorporate digital products and services. This act gives you the right to take back a faulty item and get your money back, for example, when the zip on a dress gets stuck the second time it is worn, or a vacuum cleaner that breaks down after only six months.

The key features of the **Consumer Rights** Act are:

- goods must be fit for the purpose for which they are sold; relevant aspects of 'fit for purpose' include freedom from defects and the appearance, finish, safety and long-lasting nature of the product
- the buyer has a right to get their money back, or could choose to have it repaired at the seller's expense
- the person responsible for correcting any problem is the seller (the shop), not the manufacturer.

Talking point

An angry householder wrote on the Cowboy Builders website: 'Our loft conversion was completed using the wrong materials, the insulation was incomplete and our new deck has too few supports.' How might the householder make use of the Consumer Rights Act 2015?

Trade Descriptions Act 1968

This act (passed in 1968) put an end to 100 years of misleading advertisements. One example was the cigarette brand Heartsease, which claimed to be good for your heart. The Trade Descriptions Act insists that all advertising, packaging and public statements made by firms about their products must be 'demonstrably true'. In other words, there must be evidence for them. Key features include:

- it is an offence for a trader to use false or misleading statements
- it is an offence to misleadingly label goods and services
- the act carries criminal penalties and can therefore lead to a jail sentence.

Although specific statements must be proven, for example that Yakult helps digestion, advertisers can still get around the act in clever ways. Few of the claims about 'superfoods' have any scientific support, but a yoghurt manufacturer could add acai berries to their yoghurt and then make reference to the belief that acai is a superfood.

Despite the tricks some companies use, there is no doubt that the Trade Descriptions Act has reduced substantially the number of customers being deceived by suppliers.

Other key acts

Among many other acts passed to protect consumers are:

- the Consumer Credit Act 1974 (updated in 2006): every item sold on credit must have a clear indication of the APR – the annual percentage interest rate – being charged
- the Weights and Measures Act 1985 (updated in 2006): if the bag says 500 g, that is what it must contain
- the Food Safety Act 1990: to prevent illness from eating food sold to the public, by insisting that sales staff have hygiene training and that premises are inspected regularly.

It is not important to remember these other acts, but it is important to know that there are more than just the two main acts. This is because firms often complain that they are overwhelmed by the amount of legislation they must cope with.

Why have employment legislation?

Parliament also passes laws that try to protect employees from being exploited at work. There are three main areas for employment legislation: recruitment, pay and discrimination.

Recruitment

The main law involved in recruiting new staff is the Equality Act 2010. This brought together many other Acts of Parliament largely concerned with preventing discrimination. Years ago companies complained about interference in their right to make decisions, but today few would doubt that the law points towards good business logic: companies benefit when they recruit from as wide a pool as possible, and hire as diverse a workforce as possible. It is hard to imagine that Marks & Spencer would have made such a hash of winning younger clothes shoppers if it had a younger, more diverse board of directors.

Pay

With the Equal Pay Act dating back to 1970, it is amazing that there are still such huge pay differences in the workplace. In 2021, the average full-time working man earned 18 per cent more than a woman. For black graduates the position has been worse, with pay levels 25 per cent less than white counterparts. Happily, latest government figures suggest this gap has closed to ten per cent. These inequalities have been reduced since legislation such as the Equal Pay Act, but clearly remain significant.

Discrimination

Although the above evidence on pay smacks of discrimination, there are other important issues in relation to discrimination. Recruitment is a concern, but the biggest issue may be promotion. Figure 26.1 shows that 57 per cent of employees at Compass Group are women, but they achieve only 31 per cent of the senior management roles. And only 20 per cent of the executive directors are women. The problem is probably much, much worse in terms of race. John Lewis is unusual for providing information on race. Its 2021 report shows that 15.7 per cent of shop floor staff are non-white, but among the top four managerial groups the figure falls to 4.5 per cent. Legislation alone may be insufficient; individual and social attitudes also need to change.

The percentage of women who achieve roles in the boardroom is much lower than the percentage of men

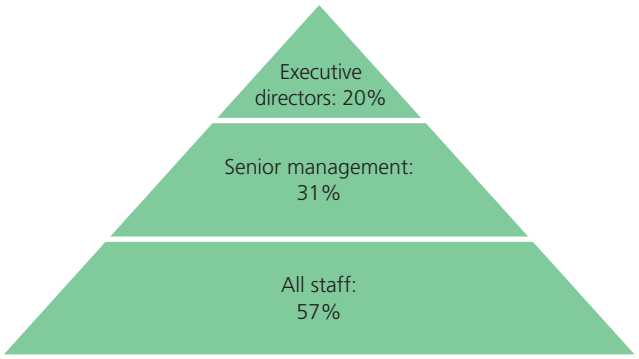


Figure 26.1 Percentage of Compass Group plc staff who are women, 2020 (Source: Compass Group annual report and accounts 2020)

The impact of legislation on businesses

The Federation of Small Businesses has carried out research among the owners of small firms. The results showed that 50 per cent thought that excessive regulation would hinder their growth in the next few years. But are firms right to feel this way? After all, just as football managers always have 'reasons' (excuses?) for their latest defeat, is it possible that business owners like to blame government for their own failings?

Many businesses say:

- too many rules mean too much paperwork, which costs time and money, and that can damage our ability to compete with foreign companies
- rules can restrict our creativity and initiative
- we don't mind rules that apply directly to us, but we object to **red tape** that we have to complete but isn't designed for 'firms like ours'.

Others argue that:

- it helps firms to know what is acceptable and what is not, for example that every cafe must have separate fridges for cooked food and uncooked food; it lets managers concentrate on doing things better
- rules do take time and money, but not enough to damage a firm's drive for success
- consumer protection law is too valuable to dismiss just because firms find it time consuming; people can die from faulty drugs, unsafe cars or a dodgy kebab.

During the 'credit crunch' of 2007–09, several major banks collapsed. They were guilty of reckless lending at a time when the government had relaxed the rules on banking. The managers, customers and shareholders of the banks would have benefited from more, not less, red tape. So too would ordinary taxpayers. The National Audit Office says that, at its height, UK government backing of the financial sector amounted to more than £1,000 billion (a trillion pounds).

> If there were no bad people there would be no good lawyers.
>
> *Charles Dickens, author*

Drawing the right conclusions

Some politicians talk as if our small businesses are weighed down by legislative red tape. In fact, international surveys such as Ease of Doing Business Index suggest that the UK is in the world's top ten countries. Furthermore, living in the UK in the twenty-first century is amazingly less polluted, safer and more pleasant than the days of the British Empire in the mid-nineteenth century. Many of the improvements are down to legislation.

Revision essentials

Consumer law: Acts of Parliament that are intended to protect customers from misleading or dangerous practices by companies.

Consumer rights: laws that empower the consumer to demand certain minimum standards from every business supplier.

Legislation: laws passed by Acts of Parliament; breaking these laws may result in a fine or even a prison sentence.

Red tape: the term given to laws that (some people say) tie the hands of businesspeople, making it hard to act entrepreneurially.

End of chapter exercises

1 Explain why there might be no need for consumer laws if every business was aiming to build long-term customer loyalty.

2 Real China was sold off by the owners before the court gave its verdict on the restaurant.

(a) Outline two possible reasons why the owners ran the business so carelessly.

(b) Explain one reason why future restaurant-goers may benefit from the awful experience of the 100 people hospitalised by Real China.

3 State whether the following incidents are covered by the Consumer Rights Act, the Trade Descriptions Act, or neither:

(a) A shop puts up a 'sale' sign but doubles the prices before 'slashing them by 50 per cent'.

(b) A pair of running shoes splits open when the wearer is running fast, eight weeks after buying them.

(c) An advertisement promises that a shampoo for men will cure baldness within a week.

4 Explain why a well-run business would want to avoid employment discrimination of any kind.

5 Fraudulent claims and scams frequently affect TikTok users in the UK. Evaluate whether Parliament should introduce new, tougher laws to restrict fashion and other influencers.

6 Middle-aged white men dominate the boardrooms in industries such as retail. Identify one reason why some people think this should continue to happen in the future, and then two arguments why it shouldn't.

Practice questions

Small firms spend four days a month battling red tape

Over half of smaller business owners (55 per cent) say that their company's growth is being held back by the amount of time they have to dedicate to business administration, according to new research from the Federation of Small Businesses (FSB).

The findings show that a small business owner spends over 33 hours every month on internal business administration, which represents almost a quarter of an individual's working hours. In addition, the average small business sees around 70 hours of employee time tied up in business admin alone.

Smaller businesses struggle to focus on their primary purposes because of the amount of administration

Two-thirds of smaller businesses (67 per cent) say the administrative burden is preventing them from focusing on their business' primary purpose. The study reveals that three-quarters of business owners (76 per cent) spend more time than they would like on business compliance, tackling issues ranging from tax, employment law issues and insurance to dealing with workplace pensions, accounting tasks or health and safety issues.

Source: Federation of Small Businesses

Total: 18 marks

1 Outline one example of a possible 'employment law' issue. (2)

2 Outline one example from the article of an administrative task created by legislation. (2)

3 From the article, outline one example of a business administration task that isn't really to do with legal 'red tape'. (2)

4 Evaluate whether the FSB has made a strong enough case to justify the headline about 'battling red tape'. You should use the information provided as well as your knowledge of business. (12)

Practice questions

Lapping up the chemicals

A food blogger has revealed the shocking differences between ingredients lists in UK and US foods, showing how US items are laden with artificial flavourings and E numbers that are banned elsewhere. Vani Hari, who goes by the moniker 'The Food Babe' online, showed the differences between common goods sold on both sides of the Atlantic, including Kellogg's Frosties, Heinz Ketchup, Milky Ways and Cadbury's Creme Eggs. The influencer, 41, from North Carolina, who has more than 450,000 followers on Instagram, describes herself as a 'healthy living activist' and shocks her followers by showing the likes of preservative BHT (butylated hydroxytoluene) and artificial colouring in US products.

An example of The Food Babe's work is the comparison below: US porridge compared with British. She says: 'I might not be the smartest person in the world, but I can read a little bit. Let's go over the UK version: wholegrain rolled oats, sugar, dried raspberries, dried strawberries, natural flavouring. That's it.'

She then turns to the US version and jokes, 'Like I said, I can read, but I don't know what any of this means. Maltodextrin sodium caseinate, red 40, that sounds scary. Can someone smarter than me please tell me why we need so many extra ingredients?'

UK vs US Quaker Oats ingredients

The answer is that the Americans don't need more ingredients, but chemical ingredients are often cheaper than natural ones. Different laws in the USA versus the UK and EU mean there are more chemicals in US versions of the same foods. Due to lack of restrictions, US manufacturers can use more E numbers. For example, BHT (butylated hydroxytoluene) is a lab-made chemical that is added to foods as a preservative. It's generally recognised as safe in the USA, but is restricted in the EU due to evidence that BHT causes cell division. Polyglycerol polyricinoleate (E476, PGPR) is an emulsifier made from glycerol and fatty acids. In Europe, PGPR is allowed in chocolate up to a level of 0.5 per cent, but there aren't restrictions in the USA.

Other additives banned in the EU and UK but legal in the USA include:

- potassium bromate and azodicarbonamide (ADA)
- red dye 40
- yellow food dyes 5 and 6
- brominated vegetable oil (BVO).

Voting for Brexit meant 'taking back control' from the EU. The question now is whether the desire to have a free trade deal with the USA will make us accept the US approach to regulation, which is often much lighter. US firms have more freedom to make their own decisions about food ingredients and health and safety than those in Britain.

Source: www.dailymail.co.uk, 11 February 2021

Total: 25 marks

1 Explain the purpose of legislation affecting consumers. (3)

2 Outline why Quaker USA may prefer to produce cereal with many more ingredients than in the UK. (2)

3 Analyse the possible implications for the environment if the UK adopted US rules regarding food manufacturing. (6)

4 A recent report said that the global market for chemical food flavourings will grow from $9.47bn to $15.2bn by 2027. By 2027 the USA, with 4 per cent of the world's population, will account for 25 per cent of global sales. Calculate the value of the US market for chemical food flavourings in 2027. (2)

5 Evaluate whether it would be right for the UK to adopt US food legislation. (12)

27 Introduction to the economy

Even if you make good decisions at every key point, starting up a new business is difficult. Making it harder still are factors outside any manager's control. Many stem from changes to the economy. For instance, a slowdown in the economy may lead to rising unemployment. If people are out of work they cut back their spending, especially on luxuries. This may lead to a sharp decline in takings at restaurants, jewellers and more expensive shops.

Many businesses start up when times are good and it seems easy to make money from free-spending customers. It is important to remember, though, that hard times can be around the corner. This should be OK as long as you have thought about how to respond to an economic downturn. In 2020, Britain suffered its sharpest **recession** in 100 years when the Covid-19 pandemic hit. At times like this, well-run businesses find new ways to appeal to customers, such as switching to online sales.

> Recession is opportunity in wolf's clothing.
>
> *Robin Sharma, business writer*

What is the economy?

The British economy is the collection of business transactions that takes place throughout the country, throughout the year. If you add up the value of all the goods and services produced in Britain in a year, the total figure comes to over £2 trillion (£2,000,000,000,000). The 'economy' is made up of lots of companies buying and selling with each other, lots of firms selling directly to customers (some here and some overseas) and lots of money raised and spent by the government.

The key to understanding the economy is to see it as a series of connected loops. If I buy a new Mini Cooper in London, I pay £25,000 to the dealer. That triggers a series of payments to:

- Oxford, where the car was made
- Swindon, where the steel body panels were made
- Hams Hall, Warwickshire, where the engine was made
- Port Talbot, South Wales, where the steel was made, and so on.

Higher demand for Minis injects money and jobs into the national economy

In fact, over 2,000 suppliers are involved in producing every Mini Cooper, and they come from Scotland and the North East as well as the areas immediately around Oxford. The higher the demand for Minis, the greater the injection of money and jobs into the veins of the national economy. As workers become

more confident of their future prospects (secure job, good income, and so on), they become more willing to spend – perhaps on a new Mini. Greater prosperity feeds on itself, creating an upward spiral.

Needless to say, if things start to go wrong, the reverse happens. During an economic downturn there is a downward spiral of falling confidence and lower spending. Cutbacks by customers in London can have knock-on effects in Oxford, Swindon, Scotland, and so on.

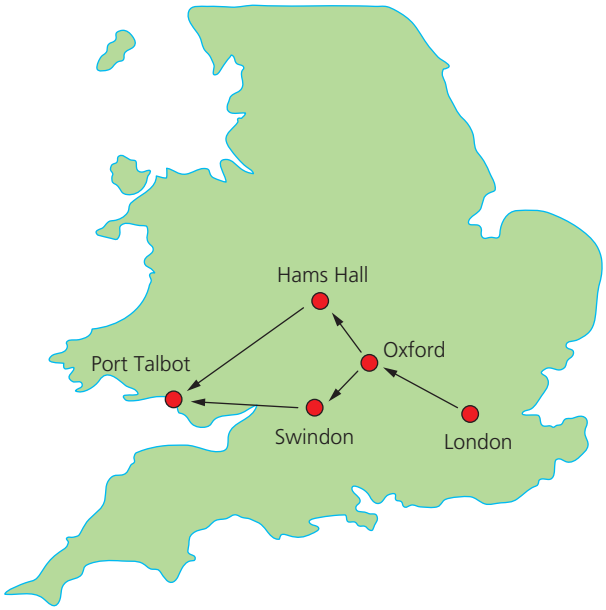


Figure 27.1 The economy is a series of interconnected loops

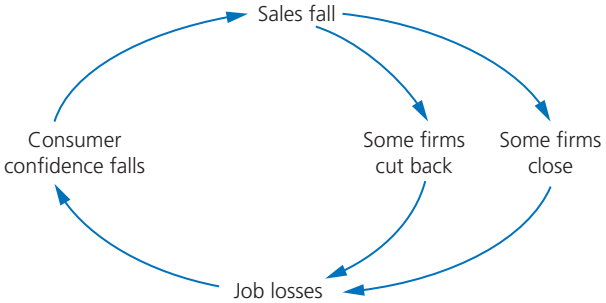


Figure 27.2 Recession creates a downward spiral

What makes the economy go up and down?

It is important to remember that Britain is one of the world's most open economies. Trade with other countries accounts for more than 30 per cent of the value of all goods and services produced in Britain per year. Therefore, if the USA gets flu, we also catch a cold. Cutbacks by US consumers would hurt our large companies in banking, insurance and car production, all of which rely on **exports**. Poor economic conditions in Europe hit us even harder, as 40 per cent of all British exports are to EU countries such as France and Germany.

Problems can also hit the economy from within the country. The decision to lock down the economy in March 2020 caused the deepest recession in 100 years. The government helped companies by paying the wages of staff on furlough, but still some restaurants, cafes and clothes shops decided to close down rather than wait for a recovery. Fortunately, when the lockdowns ended in 2021 the economy recovered rapidly.

Talking point

From your general knowledge, how well or badly is the British economy doing at the moment?

What do businesspeople need to know about the economy?

The way interest rates can change

The interest rate is the amount a lender charges per year to someone who has borrowed money. It is measured as a percentage, for example eight per cent – in other words, the borrower has to pay the lender £8 per year for every £100 borrowed. In addition, the lender must pay the £100 back, perhaps on a monthly basis.

In mid-2021 banks were charging between six and eight per cent for money borrowed to finance a business start-up. There have been times before when the rate has risen as high as 15 or even 20 per cent, making it very hard to afford the repayments. Whenever possible it is wise to get the bank to agree to a fixed interest rate, so there are no nasty surprises.

The way exchange rates can change

The exchange rate is the value of the pound measured by how much foreign currency can be bought per pound. For instance, in September 2020, £1 could be exchanged for €1.08 when travelling to Europe.

By August 2021 the pound had risen, so that it was worth €1.18. For a British tourist, the stronger exchange rate would make a European holiday more affordable. But for Jaguar Land Rover, selling a £35,000 Evoque to a French customer would be harder. A stronger pound makes UK exports more expensive – and less profitable.

The firms who would be most concerned about changes to the pound's exchange rate are:

- big importers, such as electrical goods companies or car showrooms
- big exporters, such as Rolls-Royce, who export more than 90 per cent of the products they make; for Rolls-Royce, a higher pound squeezes the profitability of their exports
- UK producers competing in the UK against foreign companies, for example JCB, which has to compete directly against the Japanese Komatsu and US firm Caterpillar.

The threat of recession

During a sharp economic downturn, thousands of people are likely to be put out of work. Some businesses cut back on staffing levels; others may collapse altogether. A few firms may flourish despite the difficulties, however, such as Poundland, Lidl and Aldi. For most, though, it is a nightmare.

A recession is a severe downturn in the economy, often described as when economic activity falls for two successive quarters of the year. Firms can usually expect that **consumer spending** will grow a little each year, perhaps about 2.5 per cent. When spending actually falls, companies struggle to cope with falling revenues and shrinking cash inflows.

Well-run companies look ahead, both to check that no recession is looming and to make sure that they can cope if one arrives. For instance, if a recession hit Europe, falls in sales of expensive VW Audis might be compensated for by rising sales of more economical VW Skodas.

Revision essentials

Consumer spending: the total spent by all shoppers throughout the country.

Exports: goods produced in one country but sold overseas, for example a British-made Mini sold in France.

Recession: a downturn in sales and output throughout the economy, often leading to rising unemployment.

Poundland flourished during the recent economic downturn

End of chapter exercises

1. Give two examples of transactions where one business would sell to another business.
2. Explain what the text means by an 'upward spiral'.
3. If a small British firm wanted to start exporting for the first time, would it prefer the pound to be high and rising, or weak and falling? Briefly explain your answer.
4. During the Covid-19 lockdowns, UK households were unable to spend as much as they would have liked. So their savings increased. Explain how this may have helped in the economic recovery that followed.
5. Read the following extract and answer questions (a) and (b).

   Students often ask: 'What does Britain export?' A surprising answer is food. In 2019 (pre-Covid-19), British exports of food and drink exceeded £23,000 million. Many of the success stories were small firms such as Walkers Shortbread and The Ice Company (yes, exporting ice!). The ten per cent strengthening of the pound in 2021 threatened to make life harder for these exporters with UK exporters to Europe and America needing to increase their prices overseas. Fortunately there are many products that come only from Britain, such as Scotch whisky and Stilton cheese. Price increases on these items shouldn't hit sales too hard.

   (a) Outline two possible benefits to small firms of finding export markets for their goods.

   (b) Small firms usually charge higher prices in export markets than in Britain. Explain why that might be necessary in order to make exporting profitable.

Practice questions

Boom in start-up restaurants in London

The number of new restaurant openings in London reached 174 in 2019, according to the London Restaurant Guide.

The figure was up on 2018, but was nearly balanced by 110 restaurant closures, the third highest on record. The following year, 2020, saw a pandemic and recession that led to even more closures.

Yet 2021 saw a return to a high number of restaurant openings – a sign that London can still compete on the global food scene. Peter Harden, co-founder of Harden's London Restaurant Guide, commented: 'The growth of London's restaurant scene is jaw-dropping in comparison to its recent past, never mind the "Dark Ages" in which we founded our guide 25 years ago. It is wonderful to be celebrating the guide's silver anniversary in what is a golden age for restaurant goers.'

Source: www.startups.co.uk, 10 November 2015

Total: 18 marks

1. Define the term 'recession'. (1)
2. Outline one challenge for entrepreneurs in opening a successful restaurant. (2)
3. Given the boom outlined in the article, analyse why there are still restaurant closures. (6)
4. Shortly after opening, a new restaurant finds that a rise in interest rates is pushing up its costs. The boss sees two options:
   - Option 1: Push up menu prices to make up for the rising costs.
   - Option 2: Accept lower profits and therefore wait longer to recover the £200,000 spent on opening the restaurant.

   Justify which **one** of these options they should choose. (9)

28 The economy and business

Changes in the wider economy add to the uncertainties involved in starting and running a business. In this chapter, six economic factors are looked at to give an idea of the impact of the **economic climate** on businesses. They are:

1. unemployment
2. changing levels of consumer income
3. inflation
4. changes in interest rates
5. government taxation
6. changes in **exchange rates**.

Unemployment

Unemployment is when someone of working age wants a job but cannot get one. As shown in Figure 28.1, unemployment is heavily associated with the overall state of the economy. During the recession that began in 2009, unemployment became a serious problem, especially for younger people. The blip upwards in 2020 was to do with Covid-19 lockdowns and the associated (short) recession.

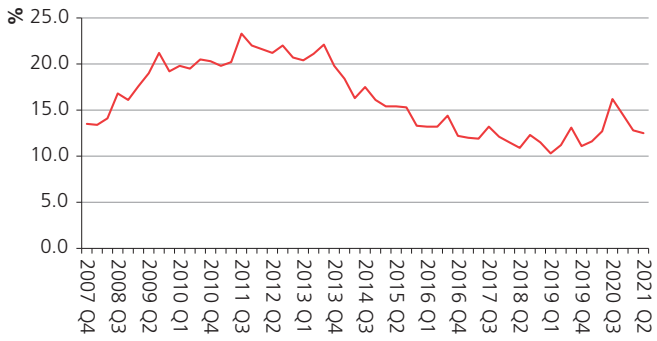


Figure 28.1 Percentage of UK adults aged 16–24 unemployed, 2007–21 (Source: ONS, August 2021)

The impact of unemployment on companies varies considerably. Producers of essentials such as toilet paper and soap will find little effect from economic highs or lows, but those producing luxury goods may find a huge effect from economic change, perhaps forcing them to make staff redundant during a recession. This can have a horrible long-term effect on trust between management and staff. A broad explanation of the effects of unemployment on companies is given in Table 28.1.

Table 28.1 The effects of unemployment

	Favourable for companies	Unfavourable for companies
Unemployment is low	Demand for most goods will be high, especially luxuries such as overseas holidays	May be labour shortages, especially in skilled work, which will make people press for higher pay
Unemployment is high	Large numbers seeking work keeps pay demands down, and stops staff leaving for better-paid jobs elsewhere	Demand for luxury goods falls, and manufacturers may worry about retail customers collapsing, as Arcadia (Topshop) did in 2020

Talking point

Look at the graph of unemployment among 16- to 24-year-olds in Figure 28.1. Describe the main changes that take place over time.

Changing levels of consumer income

Changes in the rate of economic growth can have big effects on small businesses, especially if their products are those that customers love in good times. At the start of the 2020 recession, the biggest problems came to those in the middle of an expansion plan. The inventor of the Cronut (half croissant/half donut), Dominique Ansel, was expanding his UK business with a new restaurant in London's Covent Garden. Lockdown caught him in the middle of huge cash outflows. He decided to close all his UK businesses and return to New York.

Well-run small firms remember that when business is booming, cash must be put aside. The old cliché 'put money away for a rainy day' is true for businesses and families alike. The graph in Figure 28.2 shows how consumer spending struggled in the period 2008–13 because of the weakness in **consumer incomes**. The big recovery in retail spending in 2014 and 2015 was partly due to rising incomes, and partly due to an increased willingness by consumers to take on debt. 2015 was a record year for sales of new cars in the UK; 80 per cent of those sales were on some kind of credit package. That's OK in the short term, but if households take on too much debt, they may struggle to keep up with the repayments.

Talking point

Can you think of any businesses that should do well during a recession?

Inflation

Inflation is the rate of rise in the average price level. In other words, it measures how much prices are rising. It does this in percentage terms. The 'rate of inflation' means the percentage change in prices compared with a year ago. The graph in Figure 28.3 on page 151 shows that inflation varied between 0 per cent and 7.5 per cent between 1989 and 2021. That represents a very significant variation from a company's point of view.

When inflation is low (less than two per cent) businesses can easily cope with changes to input costs such as materials. But if prices are rising more sharply (above four per cent) not only are costs a problem but also prices. Every company feels pressed to increase prices, but then they may worry about the reaction of consumers.

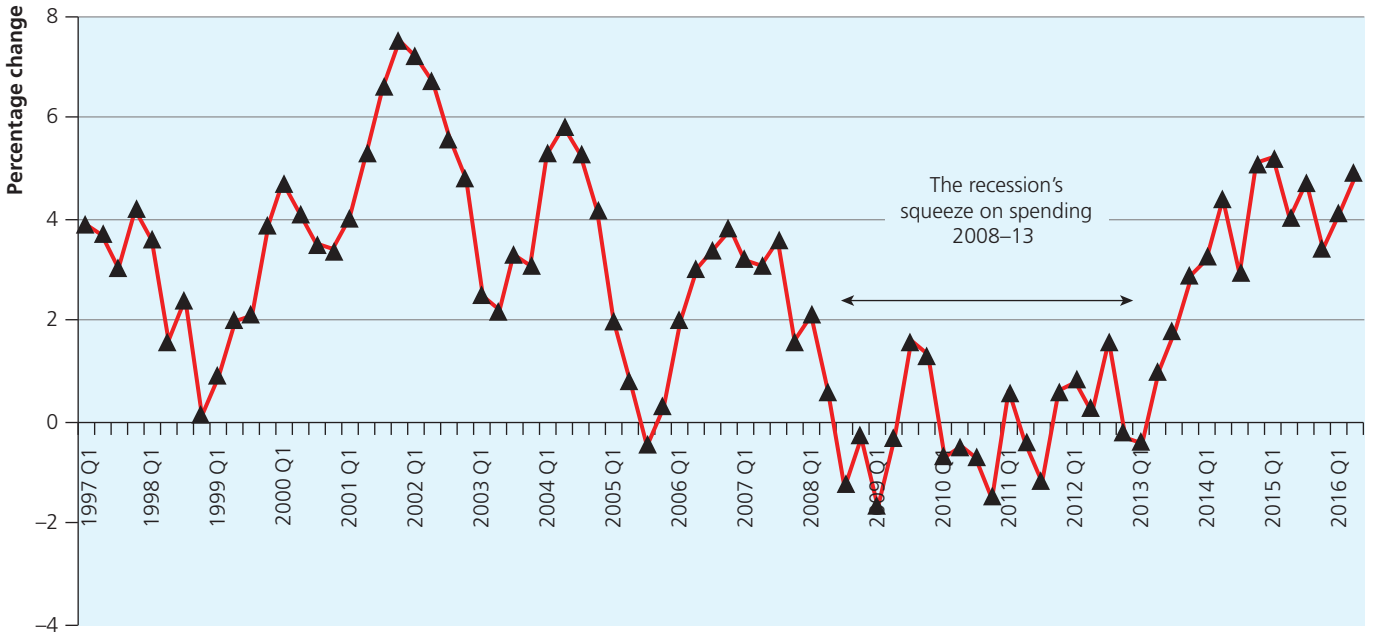


Figure 28.2 Annual percentage change in UK retail spending, 1997–2016 (Source: ONS)

For many years the government has asked the Bank of England to try to keep inflation at or around two per cent a year. As Figure 28.3 shows, they have often failed in this task.

Changes in interest rates

Seven million households in the UK have a mortgage. So, they own their home, but with the help of a building society or bank. If **interest rates** rise, their payments may rise, possibly forcing them to cut back on other types of spending. Even those with no mortgage may have big debts on credit cards or other forms of borrowing, and also need to cut back. An important concern about rising interest rates is the general effect on consumer spending and, therefore, business revenue. A travel agent may have no debts yet be hit hard by rising interest rates because of the debt position of its customers.

What are the effects of lower interest rates on businesses?

A cut in interest rates has two main effects on firms:

- Lower interest rates mean more spending, especially on luxuries such as leisure, holidays and entertainment. Higher spending means more revenue for businesses and, therefore, higher profits (and more jobs).
- Lower interest rates mean lower interest charges on firms' borrowings. As most small firms are financed largely through overdrafts, lower interest rates provide an important reduction in fixed overhead costs.

There is, therefore, a double benefit from lower interest rates: revenues go up and costs go down.

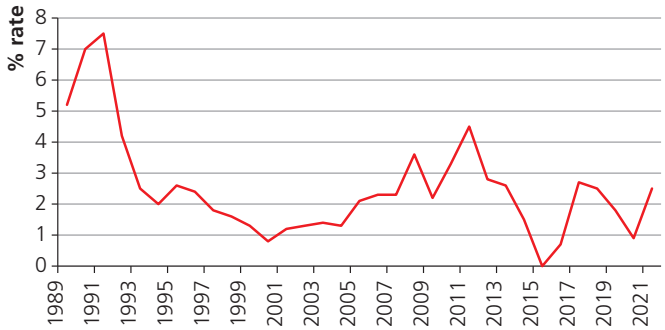


Figure 28.3 Annual UK inflation, 1989–2021 (Source: ONS Consumer Prices Index, August 2021)

What are the effects of higher interest rates on businesses?

Simply, the opposite:

- Households with mortgages need to cut back on spending because they are paying more to the bank/building society.
- Firms have higher fixed overhead costs, which squeezes their profits.

Both factors may force firms to cut back on investment spending and, perhaps, on staffing.

Government taxation

Taxes affect businesses directly and indirectly. The direct effect is from corporation tax, which is a tax on company profits. In 2021 the rate of tax was 19 per cent. So after companies have deducted all their costs from their revenues, the remaining profit is taxed at 19 per cent, the same rate that the average householder pays in income tax. If corporation tax is increased to, say, 25 per cent, companies would argue that they will be less able to afford to invest in their future. So, companies are always pushing government to reduce the corporation tax rate.

The other impacts on business come from the way that government taxes people and goods. With the UK having left the EU, it is possible that there will be import taxes charged on goods brought into the country from the EU in future. If there was a ten per cent tax on imports from Germany, for example, gearboxes and other components would cost more to manufacturers such as Jaguar Land Rover. So the level of import taxes matters.

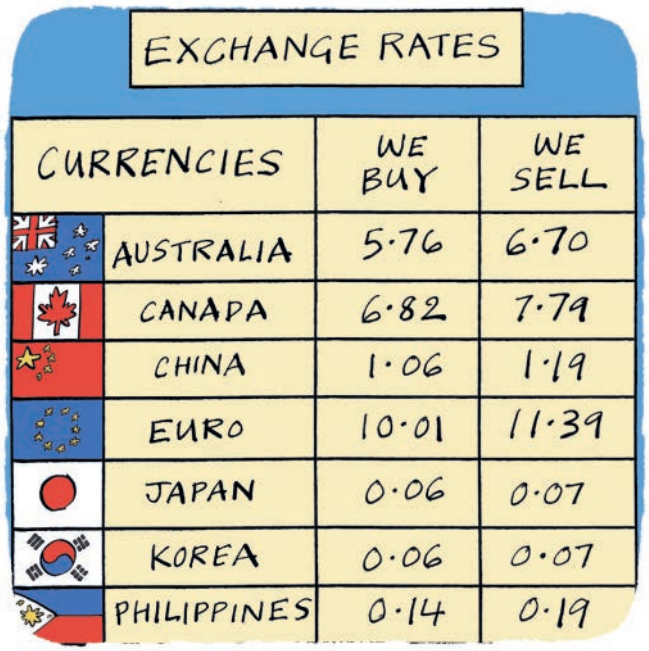
Another key factor is **taxation** on households, including VAT and income tax. Broadly, the higher the rate of tax, the harder it is for households to spend and, therefore, the worse it is for businesses.

The big compensation is that if government is trying to raise more income in the form of taxation, it perhaps wants to spend more on goods and services. Overwhelmingly governments spend their income on products supplied by the private sector, for example textbooks bought from publishers or new schools or roads bought from private sector construction companies.

Changes in exchange rates

The rate of exchange shows the value of one currency measured by how much it will buy of other currencies. If £1 buys $1.40 in March and $1.45 in April, the pound has risen in value because it buys more dollars. If the pound buys more dollars, it makes it cheaper for us to buy US goods.

Over the past 20 years the value of the pound has varied from $1.20 to $2. If £1 buys $2, then every price you see in an US shop can be halved to work out the British equivalent. For example, a $1 bottle of cola costs 50p (with $2 to the pound, you can buy two colas for £1).



EXCHANGE RATES

CURRENCIES	WE BUY	WE SELL
AUSTRALIA	5·76	6·70
CANADA	6·82	7·79
CHINA	1·06	1·19
EURO	10·01	11·39
JAPAN	0·06	0·07
KOREA	0·06	0·07
PHILIPPINES	0·14	0·19

The exchange rate is the value of one currency measured by how much it will buy of another currency

Why does a strong pound matter?

It matters because a strong pound (lots of dollars to the pound) makes it cheaper to import goods from the USA. This is great for us as consumers because US goods will seem great value. However, it is tough on British firms that are trying to compete with cheap imports from the USA. A British shopper is happy if the price of a US tablet has fallen from £350 to £290; a British computer company with production costs of £320 can make a profit at £350, but will make a loss at £290.

So, a strong pound is good for British shoppers but bad for British producers.

The knock-on effects are also important. A British producer that cannot compete with US imports may find it has to cut its staffing levels. A strong pound could lead to jobs being lost in Britain.

What if the pound is weak?

If the value of the pound is falling against foreign currencies, it is said to be weak. That means the pound buys less of any foreign currency (for example £1 used to equal $1.50, but now only buys $1.20). When the pound is weak it costs a British buyer more to buy from overseas. So, imports become more expensive, which means that people will buy fewer of them. A computer game that sells for $54 in the USA and used to sell in Britain for £36 ($54 ÷ $1.50), is now priced in Britain at £45 ($54 ÷ $1.20).

This increase in the price of imports is great for UK producers, however. Suddenly they find it easier to compete with the higher-priced imported goods. They will also find it far easier to sell overseas, because a weak pound makes our exports better value for foreign buyers.

So, a weak pound is bad for British shoppers, but good for British producers.

Exchange rate calculations

Here are the rules to follow when making an exchange rate calculation.

1. Rule 1: when exchanging from pounds to a foreign currency, multiply.
2. Rule 2: when exchanging from a foreign currency to pounds, divide.

For example, when £1 = $1.40, a £200 Burberry jacket should sell in New York for £200 × $1.40 = $280. At the same time, a $840 Calvin Klein suit should sell in Britain for $840 ÷ $1.40 = £600.

If £1 = €1.40, what price should be charged in Britain for a €28,000 Audi?

Drawing the right conclusions

Companies can be affected greatly by changes in the economic climate. Following the 'Brexit' vote, British hotels enjoyed a boom as more tourists flocked to Britain because of the weak pound. Then, in 2020, the Covid-19 lockdowns closed every hotel – and even when the lockdowns ended, international tourists were slow to return to Britain. So hotels suffered badly. It is rare for the UK economy to be so stable that businesses can simply forget about it.

Revision essentials

Consumer incomes: the amount households have available to spend after income taxes have been deducted.

Economic climate: like the weather, the economy can run cold or hot; the economic climate is a measurement of the current economic outlook, which might be promising or worrying.

Exchange rate: the value of one currency measured by how much it will buy of other currencies.

Inflation: the rate of increase in the average prices of goods and services.

Interest rate: the annual cost of a loan to the borrower.

Taxation: charges placed by government on goods, imported goods and the incomes of individuals and companies.

Unemployment: when someone of working age wants a job but cannot get one.

End of chapter exercises

1. Outline how a general fall in UK consumer spending might affect:
   - (a) Rococo, a small business making and selling luxury chocolates
   - (b) T. Hughes, a small bakery with loyal, local customers.
2. Explain why a strong pound is bad for manufacturers based in the UK.
3. Briefly explain the likely impact of a sharp rise in interest rates on:
   - (a) Tesco plc
   - (b) a car sales business specialising in new Porsche cars
   - (c) a house-building firm specialising in starter homes for young families.
4. What price could be charged in London for $175 Nike trainers when the exchange rate is £1 equals $1.25?
5. (a) If £1 equalled €1.30 last month but €1.20 this month, has the pound risen in value or fallen in value?
   - (b) What would be the effect of this change on the export price to Europe of a £200 UK-made coat?
6. Suggest one approach that could be taken by British Airways to ensure that it does not suffer too severely when the next recession arrives.

Practice questions

JCB: world class

JCB is based in Rocester, Staffordshire, and exports more than 60 per cent of its more than £4 billion annual sales. It thrives when the world's construction businesses are thriving. The impact of the global recession in 2009 is clear to see on Figure 28.4. In 2015, the company's owner, John Bamford, campaigned strongly for Britain to leave the EU. After the Brexit vote in June 2016, the value of the pound slumped by around 15 per cent. Sales of JCBs did well in China and, especially, India in 2018 and 2019. Then in 2021, the pound recovered, rising by ten per cent against the US dollar and the euro.

Total: 13 marks

1 **(a)** Calculate the percentage decline in sales between 2007 and 2009. (2)

(b) Outline one way in which JCB may have responded to this decline in sales. (2)

2 After the ten per cent rise in the pound in 2021, JCB has two options:

- Option 1: Increase the overseas prices of its excavators by ten per cent.
- Option 2: Keep the overseas prices of the excavators the same.

Justify which **one** of these options it should choose. (9)

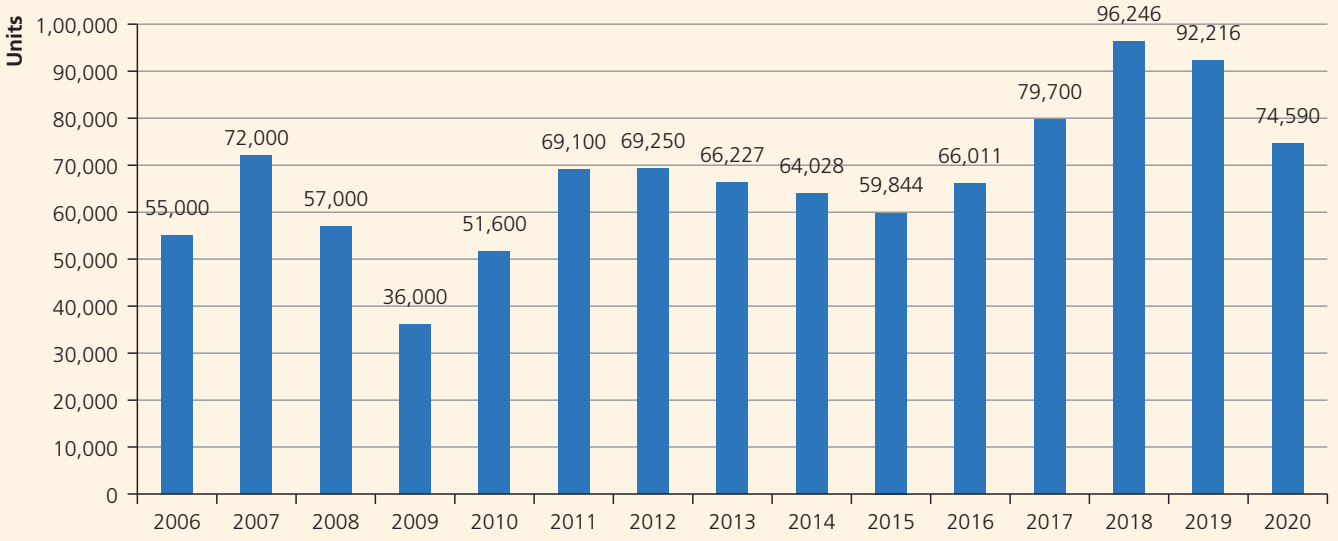


Figure 28.4 JCB's annual global sales in units, 2006–20 (Source: JCB press reports)

29 External influences on business

Although entrepreneurs want to control the future of their businesses, the reality is more complex. Individual companies find that external changes get in the way of their plans. The bigger and older the business, the more likely it is to devote time and money into an attempt to control these **external influences**. But when external change cannot be controlled, the company must respond effectively to the new challenge. This decision making has to cover changes in:

- technology
- legislation
- the economic climate.

Responses to changes in technology

For London's black cab taxis, the arrival of Uber was a ghastly shock. For more than 100 years black cabs had a strong semi-monopoly position, but suddenly it was swept away. It meant the two years spent passing 'The Knowledge' test was wasted. Cabbies saw their weekly earnings halve as Uber grew. Then they decided to fight back. Black cab campaigners pressed for all black cabs to have free, ultra-fast wi-fi and contactless card readers, as well as new zero-emissions cabs. The taxi business was responding to technological change – to the customers' benefit.

The arrival of Uber changed the market for black cabs

In other parts of the world the response has been different. In the German city Frankfurt local cab drivers have been successful in pressing the local and national government to keep Uber at bay: their response to the technological change was to use legislation to resist it. After all, you can reasonably complain that Uber drivers are unregulated, causing potential dangers to passengers and to fellow road users.

Other examples of responses by businesses to changes in technology are outlined in Table 29.1 on page 156.

Table 29.1 Business responses to changes in technology

	The action	The logic
John Lewis	In 2020 and 2021 John Lewis closed 30 per cent of all its department stores	The Partnership believes that online shopping is unstoppable, so it's best to operate from far fewer shop premises (with their huge rents and large staffing levels)
Touchlab	This Edinburgh start-up has developed a super-fine electronic 'skin' to enable robots to feel as humans do	This will make it possible to develop robot chefs who can feel whether ingredients are fresh enough to be used in the kitchen – or if they should be thrown away
TikTok	Research in 2021 showed advertising on TikTok to have more impact on teenagers than TV advertising	Advertisers such as ASOS and Converse Allstars have switched a lot of their marketing budget to advertising online, with TikTok their social medium of choice – TikTok's appeal to teenagers is a major reason for that

> The internet, like the steam engine, is a technological breakthrough that changed the world.
>
> *Peter Singer, philosopher*

Responses to changes in legislation

New laws can represent opportunities or threats to businesses. Businesspeople tend to focus more on the perceived threats, calling the new legislation 'red tape'. But it is useful to think about the business opportunities provided by new laws, and how companies have responded to those opportunities. Here are two examples:

1 Legislation introduced the Landfill Tax in 1996; it is a charge on rubbish taken to landfill waste sites. It was first charged at £7 a ton, rising to £96.70 a ton in 2021. Construction companies moaned that it would be a disaster but its main effect has been to encourage recycling. In 1999, 30 per cent of construction and demolition waste was recycled. By 2021, the figure had risen to 86.5 per cent. Companies responded to the ever-rising charges on landfill by becoming better at recycling, and new companies started up to handle the recycling for busy building firms. (Unfortunately a few rogue businesses responded to the new landfill tax by illegally 'fly-tipping', dumping their rubbish anywhere but the official, taxed sites. In 2019/20 the government reported one million fly-tipping incidents in the previous 12 months.)

2 Revisions to the Food Safety Act in 2013 forced businesses to take further measures to protect consumers. These included keeping records about who supplied each batch of food (known as traceability). Various new small businesses set up to provide simple software programs for recording food origins, and suppliers started to help restaurants and cafes by texting the source of the food.

On the other hand, many businesses bemoan the efforts they have to make to keep up with legislation. This was a factor in the 'leave' campaign for Brexit. The suggestion was that EU membership led to a big increase in laws that wasted the time and money of businesses, and that this, in turn, led British businesses to be less competitive compared with businesses in, say, Singapore, China or the USA. In fact, since leaving the EU, UK exporters, especially, would say that they have to face vastly more paperwork than they did when the UK was a member of the EU.

Among the possible responses by businesses to changing legislation are the following:

- Hire new staff to cope with the paperwork. This *was* necessary for banks and insurance companies after the Bank of England imposed tougher rules following the credit crunch of 2007–09. This would have added to their costs and hit their profits.

More normally, though, legislative changes are planned to create as little administrative burden on businesses as possible.

- Cut back or even scrap a whole area of business. When new regulations came in to restrict 'payday lenders' from charging interest of more than 100 per cent of the sum borrowed, the business collapsed. Even market leader Wonga stopped trading, as it was no longer allowed to charge interest rates of up to 1,500 per cent. In 2021, however, new lenders emerged that offer to lend at interest rates of 99.9 per cent. Legal – just.

Talking point

Do you think that introducing the Landfill Tax was a good or a bad thing?

Responses to changes in the economic climate

As the economy is changing constantly, all established businesses become used to the need to respond to economic ups and downs. In good times companies want to hire more staff, invest in equipment and spend more on developing and launching new products. The very best companies anticipate the situation by hiring and training new staff regularly, so that the right skills are available to meet rising demands. Unfortunately, many companies operate with very short-term thinking. Rising demand for skilled labour can be met with panic, and perhaps hiring skilled staff from overseas.

In the longer term, bigger companies respond to the ever-changing economic climate by spreading their risks. Jaguar Land Rover used to produce only in England, but that left the business vulnerable if a rising pound hit export profitability. Today there are JLR

JLR spread its production facilities across the world

factories in China, Brazil, Austria and Slovakia. The value of the pound is therefore much less of an issue.

For the British multinational Unilever, long-term thinking has had an even more dramatic effect. In 2001, it amazed the business world by announcing a target of having 50 per cent of its sales in developing countries. In fact, it has beaten that figure: today nearly 60 per cent of Unilever sales come from faster-growing developing countries such as China and India.

Drawing the right conclusions

Entrepreneurs soon learn that change is a regular fact of life. Responding to changes in the fierceness of competition or strength of the pound are a regular part of daily decision making. The businesspeople with real talent are those who don't just react to today's changes but – like Jaguar Land Rover or Unilever – look ahead to protect the business from future uncertainties.

Revision essentials

External influences: factors and changes from outside that might prevent a business achieving its objectives, for example, sales being hit by a sudden recession.

End of chapter exercises

1 Outline how a dramatic improvement in technology might affect:

(a) the market for games consoles, currently dominated by the Sony PS5

(b) the market for takeaway pizza, currently dominated by Domino's.

2 Explain how a UK manufacturer and exporter of cars might respond to a strong pound.

3 The government brings in a new law that all babysitters must pass a test of competence. Outline the possible effect on:

(a) businesses

(b) parents.

4 Suggest one approach that could be taken by discount grocer Lidl to ensure that it does well even when the economy is booming.

5 Look at this graph of UK economic activity and answer questions (a) and (b) that follow.

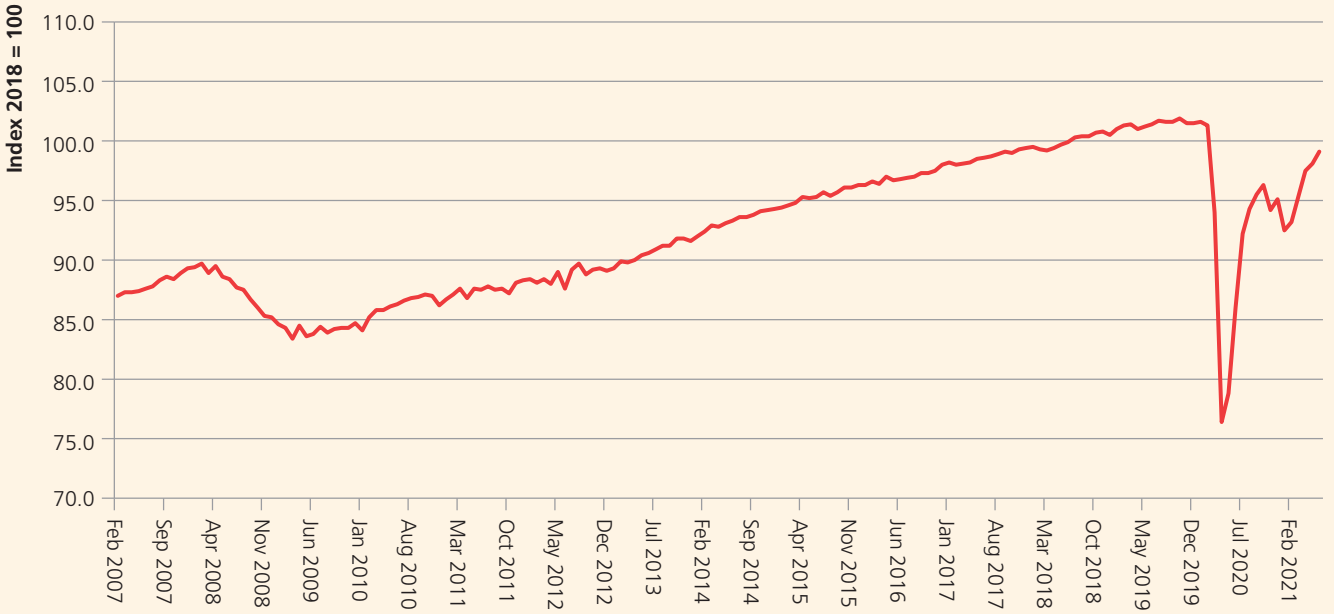


Figure 29.1 Monthly GDP data January 2007–June 2021 (Index 2018 = 100)

(a) In April 2008 the economy was at a peak. Then came a substantial recession. How many years did it take for the economy to recover to the pre-recession level of output?

(b) Even by June 2021 the economy had not recovered fully from 2020's lockdown recession. What factors might slow down an economy's recovery from recession?

Practice questions

Chaos at Christmas?

In August 2021, a Covid-19 outbreak led to a partial shutdown at Ningbo-Zhoushan port – the world's third busiest. This added to the relentless surge in shipping prices around the world. In late 2019 it cost about $2,000 to transport a container from China to California. In August 2021 that trip cost $16,000.

A shortage of shipping capacity adds to other supply problems globally: the semiconductor crunch (holding back production of the Sony PS5), the rising price of raw materials and a shortage of truck drivers. One immediate effect has been the closure of Nando restaurants; they haven't received their supplies of chicken. In the short term the big question is Christmas 2021. With container shipping so expensive, cheap toys and fairy lights from China are expected to be scarce. Commentators also worry that these cost increases will force firms to raise prices – possibly lifting the rate of inflation above three per cent.

John Glen, chief economist of the Chartered Institute of Procurement and Supply, said: 'Now is the critical point for supplies into Europe for the Christmas season.' Shortages of seasonal goods would drive inflation higher because 'there is no short-term solution and the problem is not going away soon'.

Source: Various media reports, August 2021

Total: 20 marks

1 Explain why inflation of 'above three per cent' might be a worry for UK businesses. (3)

2 Outline one way in which Nando's might act to secure future supplies of chicken. (2)

3 If a container can hold 640 children's bikes, calculate the transport cost per bike:

(a) at the container rates charged in 2019 before Covid-19 (2)

(b) at the container rates being charged in August 2021. (2)

4 Outline the effect on a UK chain of toy shops of a shortage of supplies from China before Christmas. (2)

5 If supply chaos pushes the UK economy into recession, a restaurant business such as Nando's has two options:

- Option 1: Cut its workforce by making perhaps ten per cent of staff redundant.
- Option 2: Risk making a loss by keeping all staff employed.

Justify which **one** of these options it should choose. (9)

Exam-style questions on Topic 1.5

Don't rush; check your answers carefully.

1 Which **two** of the following are probable effects of a cut in interest rates by the Bank of England? (2)

(a) The value of the pound may start to rise against other currencies.

(b) Furniture shops may find it easier to sell goods on credit.

(c) It may help the price of oil to fall.

(d) New, small firms with big overdrafts will enjoy falling interest charges.

(e) New, small firms will have less tax taken from the company profits.

2 Which **one** term means a sustained rise in the price level within an economy? (1)

(a) Higher interest rates

(b) Reflation

(c) Inflation

(d) Deflation

3 The government forecasts that consumer incomes will rise significantly in the coming year. Which **one** of these businesses would be the happiest if that forecast proves true? (1)

(a) A business that imports low-cost clothes from Sri Lanka and sells them on to street markets.

(b) A new sweetshop located in the soon-to-be-renovated Birmingham New Street station.

(c) A funeral service that has operated in Preston for the past 52 years.

(d) A newly opened clothes shop focused on expensive designer brands.

4 A banking analyst has forecast the following trend in exchange rates in the coming year:
January next year: $1.30 to the pound
April next year: $1.38 to the pound
June next year: $1.43 to the pound
Which **two** of the following are probable effects on British firms if the £'s value strengthens against the dollar? (2)

(a) UK importers of US computers would find that the cost of imports would rise.

(b) Importers of US computers would find that the cost of imports would fall.

(c) Exporters to the USA, such as Jaguar Land Rover, would be better off.

(d) All British firms would suffer as a result of this rise in the dollar.

(e) Exporters to the USA, such as Jaguar Land Rover, would be worse off.

5 Which **two** of the following identify groups that are all likely stakeholders in a local Ten-Pin Bowling business? (2)

(a) Local pressure groups, local hospitals, local customers.

(b) The government, the owners, the Climate Emergency pressure group.

(c) Employees, suppliers and the local community.

(d) Customers, shareholders and the local community.

(e) Environmental campaigners, managers and the wider community.

6 Which **one** of the following is a reason why UK businesses grumble about the high standards imposed by health and safety legislation in the UK? (1)

(a) They say it makes it hard to compete with overseas-based producers.

(b) They worry that they're forced to make goods to too high a standard.

(c) They think consumers should be free to make their own decisions about what they buy.

(d) They think the NHS will be able to deal with unhealthy staff perfectly well.

7 The UK government has set a target of net zero carbon emissions by 2050. Yet it's still keen to approve new oilfields in the North Sea. Which **one** of the following is the most likely explanation? (1)

(a) The government is not serious about linking policies to objectives.

(b) The government expects changes in consumer spending and lifestyles to achieve the target.

(c) The government's plans will deliver the target despite new oilfields coming on stream.

(d) The government expects the oil industry to find its own ways to achieve net zero.

8 Which **two** of the following factors might damage a restaurant entrepreneur's chances of success if interest rates rose sharply just when the business opened its doors to customers? (2)

(a) Prices might rise as a result of the effect on inflation, hitting customer demand.

(b) If the business had a loan or overdraft, rising payments to the bank would hurt cash flow.

(c) Customers with monthly mortgage bills might choose to eat at home more.

(d) Increasing payments to the government would increase cash outflows.

(e) If the government cut welfare benefits it could rob the business of some customers.

Now try this discussion question.

9 Discuss what an entrepreneur could consider when deciding whether to open a new business when unemployment is high. (6)

Theme 2

Building a business

30 Methods of growth

When a market is growing, it is especially important for businesses to grow. If you get left behind you become less and less significant as your market share declines. That, in turn, threatens your existence. Retailers may stop selling your products.

There are two main ways to grow:

1. **Internal (organic) growth**, which can come from selling more of your existing products, opening new stores/outlets, or developing and launching new products.
2. **External (inorganic) growth**, which comes from buying other companies or merging with another business.

> It's very easy to be different but very difficult to be better.
>
> *Jonathan Ive, chief design officer at Apple*

In 2005, two experienced food marketing executives started Fever-Tree. The brand's proposition is all-natural soft drinks, such as tonic water. The premium positioning and pricing helped Fever-Tree to quickly gain acceptance by 75 per cent of the world's top restaurants. Entirely by organic growth, sales fizzed up from £2.3 million in 2008 to £260 million in 2019. Not even the closure of bars and restaurants during the Covid-19 lockdowns held the business back, so 2020 was also very successful. The expectation is that sales will continue to rise strongly for the next few years. The company's growth has come from launching new, successful products, finding more retail distribution and launching into more than 50 countries. Fever-Tree exports more than half its sales.

How to grow organically

New products

Most companies begin with one product idea. If it is successful then it is natural to look for related products that might also be successful. Fever-Tree started with tonic water; when that was well-received by restaurants and bars, the company developed a ginger ale, then a bitter lemon, then a Sicilian lemon, and so on. When a product range expands in this way, it becomes possible to interest more customers. A bar might not be interested in stocking Fever-Tree tonic alone, but if it can buy all of its mixers from one company, it may throw out its previous mixers and go with Fever-Tree exclusively. In this way, the company can enjoy sustained, substantial growth.

For most companies, the only way to persuade retailers to stock a new product is if it is distinctive and innovative. **Innovation** means bringing something new to the market. The Swiss chocolate-maker Lindt did this successfully with its Lindor brand – different in taste and mouthfeel, and more luxurious than traditional, beloved Cadbury. With UK sales of £186 million in 2021, Lindor now outsells all the traditional chocolate boxes (Nestlé's Quality Street, Mars' Celebrations and Cadbury's Roses).

To be innovative, companies need to spend consistently on **research and development (R&D)**. This means scientific research into, perhaps, melt-free chocolate (crucial for building sales in hot countries such as India) or into strong but light materials to enable cars and aeroplanes to become more fuel efficient. This must be followed up by careful technical development to make sure that the idea

can be turned into a business reality, through careful engineering and production testing and planning.

Lindt brought something different to the chocolate market

Table 30.1 The benefits of good R&D

Examples of science-led innovations	Examples of technical developments
The discovery of lithium batteries in 1980 has been crucial for developing electric cars, notably Tesla electric cars	Toyota, the inventor of hybrid cars such as the Prius, is now working on hydrogen-powered cars. You can buy its hydrogen Mirai today, but it will cost you £65,000
2020 saw amazing triumphs from traditionally-made vaccines against Covid-19, plus the hugely innovative mRNA vaccines such as those made by Pfizer and Moderna. Pfizer expects sales of $33.5bn of its Covid-19 vaccine in 2021	Wireless battery charging. This technology was known for 100 years before development engineers saw the huge opportunity for wireless charging of mobile phones
In 2021, some executive cars boast 'magic body control'. While driving, a sensor might spot a big pothole and automatically adjust the car's suspension so that the bump is absorbed smoothly	The newest aircraft such as the Airbus A350 are 25 per cent more fuel-efficient and much quieter than in the past, due to the use of newer, lighter materials

New markets

For most businesses, finding and developing new markets is difficult and expensive. Superdry plc pushed hard to grow its business in the USA and China in 2016 and 2017 before realising that it was dragging the whole company down. It changed its mind and now focuses on the UK and Europe.

To grow by moving into new markets overseas means a series of (often expensive) challenges:

- promoting an unknown brand into a market that you don't yet know and understand
- learning about the local distribution system, so that you can master the 'place' aspect of the marketing mix
- building a new management team and structure in a new country, and all the recruitment and training mistakes that this can entail.

Table 30.2 UK successes and failures in looking for new markets overseas

Successes	Failures
Upmarket clothes designer and retailer Burberry moved into China 20 years ago. Around 40 per cent of its annual sales of over £2.5 billion now come from Chinese customers	Tesco wasted £2 billion failing to establish a grocery chain in the USA and paid a Chinese company to take Tesco Fresh & Easy off its hands. Tesco now focuses on the UK
In 2013, Kent Crisps Ltd started exporting to Italy. Today it exports to the USA, the Middle East and Asia, with different countries liking different flavours (salt and vinegar is a no-no in Asia). More than 80 per cent of its sales are exports!	In its 2018 financial year, Domino's Pizza UK made about £90 million profit in the UK – and lost £30 million in its 'international division' (operating in Switzerland, Norway and other countries). In 2019 it closed most of these businesses down to focus on the UK
Ella's Kitchen (baby food) started in 2006 and by 2019 had sales of more than £75 million, including exports to more than 40 countries	Purplebricks has been an innovator in the UK housing market. It created competition for estate agents. But when it tried to reproduce its success in the USA, it flopped badly – and expensively

The great strength of the UK's membership of the single European market was that it gave UK companies free access to a market of more than 500 million consumers. In effect the European market was our home market.

New markets don't have to be overseas, however. Companies with technological expertise can use it to develop different opportunities. At the core of Google is a mastery of computer logic; this is what

makes its search engine so effective. The company thinks that this expertise can be used to make self-driving cars safe, effective and desirable. On the face of it, a move from computer search engines to making cars is an extraordinary one, but welcome to the world of Google. Companies with a strong base in technology have every chance of growing by developing new, interesting market opportunities.

A final way to move into new markets is to rethink your marketing mix. Few have done this as brilliantly as Lucozade. For decades this had been marketed as a drink to provide energy for the elderly – a present for gran. It was in a big glass bottle. In the 1980s Lucozade Sport was brought out, with completely different packaging and a bright new image. The whole marketing mix was re-thought – and the results were spectacular. Sales went from less than £20 million a year to today's £300 million plus.

How to grow inorganically

Takeovers

In 2008, the world's biggest chocolate business, Mars, bought the global leader in chewing gum, Wrigley, for $23 billion. This gave Mars a growth boost because, while global chocolate sales were grinding to a halt, the chewing gum market was growing. It also gave huge scope for financial benefits in two ways:

- It made the combined business an even more powerful negotiator when talking prices with supermarket chains, therefore helping to push prices up.
- It enabled costs to be cut, for example merging the Mars and Wrigley salesforces and delivery systems into one (at the cost of many jobs).

Buying Wrigley helped Mars diversify its business

When one private limited company wants to take over another, phone calls are made and – if the price is right – a deal is done. It can only happen if the owners of more than 50 per cent of the share capital wish to sell up. As many private limited companies are family owned, there is some scope for big rows and falling outs but eventually a decision is made.

> [When making a takeover] go for a business that any idiot can run – because sooner or later any idiot is probably going to run it.
>
> *Peter Lynch, businessman and investor*

With public limited companies (plcs) things can be more complicated. To persuade the shareholders of another company to sell up, the bidder must offer a reasonably generous price premium. This is usually 25–40 per cent. So, the shareholders stand to make a profit of 25–40 per cent instantly. But they may realise that a rival bidder may appear, potentially pushing the share price still higher – and so may refuse to sell. In 2021, a bidding war for Morrisons gave the supermarket chain's shareholders a 50 per cent profit compared with the pre-bid share price.

The **takeover** becomes a reality when more than 50 per cent of shareholders have sold to the bidder. The other 49.9 per cent might as well accept the bidder's terms, because the battle has been lost. Once the bid has gone through, a number of things tend to happen:

- The winner takes full control, and many of the losing company's senior staff leave.
- Over the following months a series of decisions will be made about who stays and who goes, and who will be appointed to the new, bigger management jobs.
- Later, there may be important decisions about cutting back on products, brands or services that overlap. After Ferrero bought Thorntons chocolates for £112 million, many children's product lines were stopped because they overlapped with Ferrero's famous Kinder product lines such as Kinder Eggs. Staff lost jobs as a result.

So, who are the winners and losers? The only guaranteed winners are the shareholders who sold

out at a profit. Shareholders in the winning company often do much less well, as research shows that most takeovers prove a disappointment. Among other winners are the City advisors, who may receive hundreds of millions of pounds for their advice.

The losers include the managers and staff who lose their jobs, and the customers who find there's a little less competition in the high street, or that their favourite beer or chocolate bar is no longer made.

Talking point

What might be the effect on customers and workers if Tesco bought Sainsbury's?

Merger

A **merger** happens when the shareholders of two similarly sized businesses agree to share ownership and control. The two separate businesses become one, of approximately double the size, and therein lies the problem. If your school was to suddenly double in size, it would put great strains on the school leadership and management, and that's what happens when mergers occur. The change is often too much and too fast.

The Dixons and Carphone Warehouse merger was a successful one

One of the biggest merger disasters was when Daimler-Benz (Mercedes) of Germany merged with Chrysler of the USA. Despite both being in the car business, there were constant disagreements. By the time they agreed to part, Mercedes had lost more than $50 billion, while Chrysler lasted only a year before needing to be bailed out by the US taxpayer.

By contrast, the merger of Dixons and Carphone Warehouse to form Dixons Carphone seems to be a success. There is a core management team representing both sides of the business – electronic hardware plus mobile phones. The business was renamed Currys plc in October 2021.

> Every single time you make a merger, somebody is losing his identity. And saying something different is just rubbish.
>
> *Carlos Ghosn, former boss of Nissan and Renault*

Drawing the right conclusions

Many businesses have tried to succeed simply by external growth; it has very rarely worked. World-leading companies – such as Google, Facebook, Toyota and Apple – have organic growth at their heart, even if they have used a few takeovers along the way. Organic growth ensures that staff have a sense of what the business is really about: be it knowledge (Google) or social connection (Facebook).

While organic growth is preferable, there are times when a takeover is necessary, such as when Coca-Cola bought Costa Coffee to provide access to the fast-growing coffee market, or when Unilever (owners of Wall's ice cream) bought Russia's leading ice cream-maker to access the huge Russian market.

As with every aspect of business, there is no single answer to the question of growth.

Revision essentials

Innovation: bringing a new idea to the market, such as Warburtons' clever idea of an extra-large crumpet.

Inorganic (external) growth: growing by buying up other businesses or by merging with a business of roughly equal size.

Merger: when two businesses of roughly equal size agree to come together to form one big business.

Organic (internal) growth: growth from within the business, such as creating and launching successful new products.

Research and development (R&D): the scientific research and technical development needed to come up with successful new products.

Takeover: obtaining control of another business by buying more than 50 per cent of its share capital.

End of chapter exercises

1 Outline two significant risks that might be faced if Sainsbury's decided to expand by opening a chain of stores in France.

2 Outline two things that might go wrong for Coca-Cola after its successful purchase of Costa Coffee in 2018.

3 What is the difference between research and development and market research?

4 Read the following extract and answer questions (a) and (b).

In 2015, entrepreneur Adam Levene founded Hero, a social shopping e-commerce business. It was to provide a more personal shopping experience for its users. It created a market in the UK and the USA, raising $10 million in external capital to finance its growth. Then, in July 2021, online payments giant Klarna bought Levene's shares in a full takeover of the business. Klarna saw a great fit between Hero's online sales and its own online payments system. Klarna said that all 100 Hero staff would keep their jobs.

(a) Why may Klarna have decided on inorganic growth rather than developing its own online shopping platform?

(b) Explain why the Hero staff may still feel worried about their futures.

Practice questions

Genius growth

Genius Foods was founded by chef Lucinda Bruce-Gardyne, who wanted better-tasting gluten-free bread for her son, who had been diagnosed as gluten intolerant. After failing to find any decent products for sale, she decided to create something herself. Genius bread hit the supermarket shelves in 2009.

The growth of the business was sensational. Bruce-Gardyne had stumbled upon a rapidly growing sector of the grocery business, so-called 'free-from' foods. Genius sales hit £40 million by 2014, and market experts suggested that sales would rise a further 50 per cent by 2016. Much of the growth came from the launch of innovative new breads and other baked goods such as gluten-free crumpets, pizza bases and pitta bread.

In addition to this organic growth, Genius made two important takeovers. In 2013, it paid £21 million for two free-from bakeries from the Finsbury Food Group. This allowed the business to bake its own products for the first time. And, in October 2015, it paid £3.5 million for Chapel Foods – a producer of gluten-free filled pastry.

In 2016, Genius announced the launch of a range of frozen, gluten-free pastry products, from steak pies and sausage rolls to apple pie. Supermarkets such as Waitrose and Sainsbury's were quick to announce that they would be stockists. Genius wanted its slice of this market and also announced plans to launch in Germany, France and Holland. Its growth ambitions were made clear when Bruce-Gardyne told *British Baker* magazine in April 2016 that her aim is for Genius to become the world's leading free-from bakery business. Yet despite all this effort, both sales and profits struggled. In 2017 sales collapsed from £47 million to £35 million and by 2019 they were just £34 million. The 2019 profit for the year was *minus* £4 million. Growth is exciting, but not always successful.

Total: 15 marks

1 Define the term 'organic growth'. (1)

2 Outline one reason why innovation can be important when growing organically. (2)

3 Calculate Genius sales in 2016 if the 'market experts' were right. (2)

4 Define the term 'aim'. (1)

5 To **return to profit**, Genius may have to choose between:

- Option 1: Organic growth.
- Option 2: Inorganic (external) growth.

Justify which **one** of these options Genius should choose. (9)

31 Finance for growth

One night in Paris in 2008, Americans Travis Kalanick and Garrett Camp had trouble getting a taxi. They came up with a simple idea: tap a button, get a ride. Uber was born. In October 2010, it received its first venture capital investment of $1.25 million. By mid-2021 the business was valued at an astonishing $77 billion.

How does any business finance expansion? There are broadly two options: from within the company's own resources (internal finance) and from outside (external finance).

Internal sources for financing expansion

Retained profit

Richard Branson began his empire at the age of 17 when he launched the magazine *Student*. His early venture was so successful that he used his profits to set up Virgin, a mail-order record company. Today, most small businesses think the same way. They try to finance growth from retained profit. Unfortunately, that tends to mean quite slow growth. To make a leap forward (perhaps by buying a rival) it is often necessary to go outside, that is, to look for external finance.

Selling assets

In August 2021, Richard Branson made over £250 million from the sale of shares in Virgin Galactic, his space tourism business. Over many years Virgin has done this: develop a new business idea then sell it off – using the cash to invest in something new. This keeps Richard Branson in control (as compared with selling shares in the Virgin Group) and avoids building up big debts.

Smaller firms might sell off their buildings and then rent premises, or may sell off computer equipment and choose to lease equipment instead. The main drawback is that while this can be an effective way of raising large sums of capital, it can work out more expensive in the long term.

One of the best-ever examples of selling assets was when Whitbread plc sold off David Lloyd Leisure and invested the money in a small chain of coffee shops. When they bought Costa there were just five outlets. When they sold the business to Coca-Cola in 2018 there were 3,800 coffee shops. No wonder Coca-Cola was willing to pay £3.9 billion.

External sources for financing expansion

Loan capital

Debt is never desirable, but it may be necessary sometimes. A bank loan is the most common source of external finance for expansion plans. Research done in 2020 showed that 75 per cent of external finance for expansion came from bank loans. The same research, though, said that more than 50 per cent of loan applications from young businesses (under five years old) are turned down. Banks only lend if they can charge substantial interest rates, and only if they can get the loan secured against a specific asset (usually property).

> A bank is a place where they lend you an umbrella in fair weather and ask for it back when it begins to rain.
>
> *Robert Frost, poet*

Share capital

A limited company can sell more shares to finance its growth. A private limited company is not allowed to advertise the sale of shares, so they are only sold to family or friends. It is nice to keep control within the family, but few families are wealthy enough to provide a really big injection of cash. In this case the business may need to apply to become a **public limited company (plc)** and perhaps list the shares on the stock market. The process of getting a stock market listing is called **flotation**.

Public limited companies

The basics

A plc is likely to be listed on the stock market. Therefore, its shareholders may be numbered in the hundreds of thousands (as with Tesco and Marks & Spencer). All these small shareholders are likely to be interested mainly in whether the business is making big profits. They are hoping for big annual dividend payouts to shareholders plus a booming share price. Although all shareholders have the right to attend the annual general meeting (to grill the company directors), few bother.

The benefits

Plcs have access to the massive financial power of the stock market. In April 2020, in the first month of Covid-19 lockdown, WHSmith raised £150 million and recruitment giants Hays £200 million from the stock market to give them the funds to get through the coming recession. This was brave on the part of investors – and life-saving for a number of plc businesses.

A further benefit of the plc structure is that the known value of the shares makes it easy for a business like Hays to make a bid to take over another company. So, the organisational structure of a plc makes it easier to make external growth happen.

The downsides

Plcs not only find it easier to buy other businesses, but are also more vulnerable to being bought by others. In 2021, cigarette maker Philip Morris bid 165p a share to take over a UK drug manufacturer, Vectura. This gave the shareholders an instant 40 per cent profit on their shares. There is no reason to suppose the Vectura directors wanted to sell the company, but the decision was in the hands of the shareholders.

Argos was bought by Sainsbury's in 2016

In the long term it may hurt our economy that we accept so many takeover bids from foreign firms for our companies. Examples include the following:

- Jaguar Land Rover was bought by Tata Motors (India)
- Cadbury was bought by Kraft (America)
- Weetabix was bought by Bright Food (China)
- McVitie's was bought by Yildiz (Turkey)
- ARM (world-class chip designer) was bought by Softbank (Japan) then sold on to Nvidia (USA).

Stock market flotation

When the fashion retailer Joules floated on the London stock market, it raised £140 million from shareholders. Founder Tom Joule started the business when he was 21 and was now enjoying a £48 million payday, though his shareholding was cut from 80 per cent to 32.3 per cent. The rest of the capital raised was used to pay off bank loans and to provide capital for expansion. Table 31.1 shows the advantages and disadvantages of stock market flotation.

Table 31.1 Advantages and disadvantages of stock market flotation

Advantages	Disadvantages
Provides a sudden, possibly huge, injection of share capital into the business	A sudden injection of a lot of money can tempt managers to be too ambitious, e.g. Superdry plc and ASOS plc, which both over-expanded after flotation
An excellent source of capital for a rapidly expanding business (safer than big bank borrowings)	Suddenly selling so many shares means the founder's holding may fall below 50 per cent, therefore losing control
'Going public' raises the profile of the business (perhaps making it easier to win big contracts from big companies)	The higher profile means shareholders and the media critique each quarter's results – perhaps encouraging short-term decision making

Talking point

Richard Branson's Virgin Group was once on the stock market but he chose to buy it back to keep it as a private company. Why may he have chosen to do this?

Figure 31.1 shows how the growth of Fever-Tree was helped by its 2014 stock market flotation.

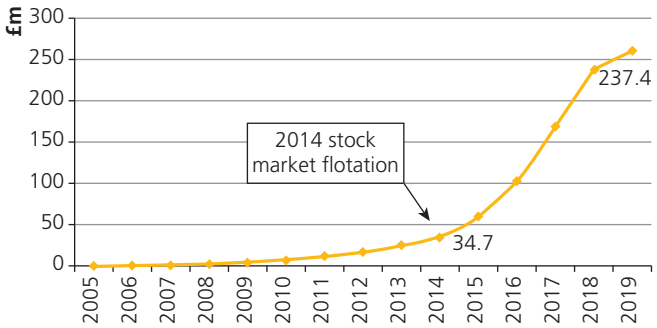


Figure 31.1 Fever-Tree's annual sales turnover, 2005–19

Risk and business expansion

One of the riskiest times for businesses is when they are growing fast. It is easy for the cash outflows to rise faster than the cash inflows. So, it is important to get enough finance and to make sure it is the right type.

The worst type of finance is an overdraft. This is because, if something goes wrong, the bank can demand to be repaid within 24 hours. The best type of finance for growth is share capital, because this never has to be repaid. The business has the shareholders' investment forever. If shareholders want to get their money back, they must sell their shares to another buyer (which is what the stock market is all about).

A good way to look at financing risks is to look at the difference between debt and shares. There are two main reasons why shares are less risky than debt:

- Borrowing money forces a company to pay interest even in a tough year, whereas share capital involves dividend payments that can be cancelled if necessary. Debt (such as a bank loan) has interest that must be paid. If it isn't paid, the company can be closed down.
- Borrowed money has to be repaid, therefore a three-year bank loan of £200,000 not only involves a lot of interest, but the £200,000 also has to be paid back. Money raised by selling shares *never* has to be repaid. So £200,000 raised by selling shares is much safer than £200,000 borrowed.

Drawing the right conclusions

Business growth requires careful financing. Entrepreneurs should forecast their cash flows then look to find internal sources of finance to cover any shortfalls. Only if that looks insufficient is there a need for external finance. A careful balance then needs to be struck between the desire for control (therefore *not* selling shares) and the desire for financial safety (therefore *not* getting into too much debt). No one said business is easy.

Revision essentials

Business growth: factors allowing a company to expand through higher sales and (usually) higher staff levels.

Flotation: listing company shares on the stock market, allowing anyone to buy the shares. This means the price can float freely (up and down).

Public limited company (plc): a company with at least £50,000 of share capital that can advertise its shares to outsiders and is, therefore, allowed to float its shares on the stock market.

End of chapter exercises

1. A 20-year-old wants to start an aerobics gym. It will cost £60,000 to set up, but she only has £16,000. Outline two suitable ways of raising the rest of the capital.
2. A local double-glazing company is considering expanding its product range to include conservatories – it needs £300,000 to do this. Discuss the external options available to the company to raise this amount of cash and make a recommendation about what it should do.
3. A local hairdresser has the opportunity to buy a second shop. Her family has offered to buy a 60 per cent share in her business – this will give her the money she needs for expansion. Alternatively, she could take out a loan. What should she do?
4. Using Figure 31.1 on page 169, calculate Fever-Tree's percentage sales growth between 2014 and 2018.
5. Explain why a sudden injection of a lot of cash from a public flotation might lead a business to make more reckless decisions.

Practice questions

Dragon-tamer

In 2015, Yee Kwan appeared on the BBC's *Dragons' Den* looking for finance for her range of 23 oriental ice creams and sorbets. Although some flavours (such as Matcha Tea) are very unusual, others, such as mango sorbet, could appeal to most people. Once the dragons had tasted some of the flavours, Deborah Meaden and Kelly Hoppen fought hard to invest. Deborah Meaden won, paying £50,000 for a 30 per cent share stake in the business. The money was used to increase production capacity and to train a new ice cream-maker, freeing Yee to spend more time selling and managing the business.

Yee started her business in 2009 and, by 2014, had a sales turnover of £100,000 a year, selling to some upmarket shops such as Harvey Nichols and some Japanese and Chinese restaurants. In 2013, she opened an ice cream stall in Moor Market in her home town of Sheffield, but she had to close within six months because of lack of interest.

Following the *Dragons' Den* appearance – and with the help of Deborah Meaden – Yee Kwan's business has flourished. Stockists now include Whole Foods Market, Ocado and a string of well-known restaurants in London and around the country.

Yee has also developed both a vegan range of ice creams and a very impressive e-commerce website. Nationwide free, refrigerated delivery is on offer, as long as you buy more than £20 of ice cream. In 2021, she made an important breakthrough, becoming the ice cream supplier to all 180 Wagamama restaurants.

Total: 20 marks

1. Outline one reason why Deborah Meaden might have been willing to invest £50,000 in Yee Kwan ice creams. (2)
2. Analyse why Yee may have chosen to appear on *Dragons' Den* rather than take a loan from the bank. (6)
3. Evaluate the impact of this form of venture capital investment on the success of Yee Kwan ice creams. You should use the information provided as well as your knowledge of business. (12)

32 Changes in aims and objectives

Aims and objectives were introduced in Chapter 13. But why might a company's aims and objectives change over time?

> Arriving at one goal is the starting point to another.
>
> *John Dewey, nineteenth-century philosopher*

Why aims and objectives change as businesses evolve

Businesses evolve over time as they adapt to changing circumstances; those that fail to evolve may die out like dinosaurs. As part of the process of evolving, aims and objectives often change. When Associated British Foods (ABF) opened the first Primark shop in Derby in 1973, it expected little from this new initiative. Back then, ABF was a highly profitable producer of sugar, wheat and bread. In the years that followed, the strengthening of the supermarket chains made it harder to make profits from basic foods like sugar and bread. So, ABF steadily put more and more investment behind Primark, seeing it as a path to future security and prosperity for the business. By early 2020, more than half of ABF's profit came from Primark – the evolution was complete.

Aims and objectives change in response to the following:

- Changing market conditions: In the ABF example, the increasing dominance of supermarkets such as Tesco was an important factor. For Cadbury, the market share gains made in the UK by Ferrero and Lindt (Lindor) were the first thing to dent its success in years. In response Cadbury is setting new objectives in relation to the luxury/higher priced segment of the UK chocolate market. If competition strengthens, you must respond.
- Changing technology: For many years Sony's games console business had made money selling hardware and software. Both were sold through shops that took a significant slice of the profits. The growth of online sales and downloading have made it far easier for Sony to sell direct to customers – cutting out the 'middleman'. Even before the launch of the PS5 it allowed Sony to increase its PlayStation profits by 50 per cent between 2018 and 2020.
- Changing performance: If a company's costs start to slide upwards, its profits will inevitably be squeezed. This happens most commonly when things are going well, perhaps thanks to a fashion-based boost to sales. So, sales are up and revenues are up, but management allows costs to go up as well (pay rises for staff, new job titles and salaries for managers, bigger expense accounts, and so on). Then, when the fashion tide turns, revenues slip back but those new, higher costs stay high. Either the existing boss has got to do an amazing job of getting costs back down or (more probably) a new boss will be appointed. The new one will set new objectives in relation to costs and profits, and make the necessary, perhaps severe, cutbacks.
- Changing legislation: After the UK left the EU in 2021, there was uncertainty about what changes would be made to UK laws by the British Parliament. Some changes might benefit particular companies; others might be damaging. But uncertainty is the worst thing of all for businesses. Uncertainty makes it impossible to set new objectives and start planning for how to achieve them.

The games console leaders

- Internal reasons for change: The aims and objectives of a business can be affected hugely by a change at the top. If a boss is pushed out and a new one appointed, it is common for there to be some change to the aims and objectives. Even if there's no change to the written aims and objectives, the new person's priorities will soon get through to senior managers.

After a visit to the Hawksmoor steakhouse, customers are sent a questionnaire from the office of Will Beckett, one of the founders. A complaint about the steak gets a quick response from Will and the offer of a free steak by way of apology. When Will follows up with the kitchen, it is clear to all that quality is the top priority, and that no aim is more important than preserving Hawksmoor's excellent reputation. If someone like Will is brought in as the boss of an averagely run restaurant, the importance of the change will soon be clear to all the staff (and then the customers).

> Pursue one great decisive aim with force and determination.
>
> *Carl von Clausewitz, German general and strategist (1780–1831)*

How aims and objectives change as businesses evolve

Aims and objectives can change in the following ways.

Focus on survival or growth

When David Potts took over Morrisons supermarkets in 2015, he was clear from the start that survival was an issue. In other words, unless

Morrisons made significant changes quickly, it might go out of business. He cut back sharply on the number of senior managers, sold off loss-making small 'convenience' stores and did an e-commerce deal with Ocado. He also found the finance to hire more shop-floor staff to reduce the queue length in-store. As we saw in Figure 8.1 (page 40), Morrisons had been suffering as much as Asda and Tesco from the Aldi/Lidl onslaught. By 2021 there was renewed confidence that Morrisons' market share had stabilised and the business was profitable. So much so that the business was taken over with a bid worth £10 billion. The objective had been survival, but ended up with huge gains for Morrisons' shareholders.

In other cases the change will be to seize growth opportunities, in just the way that Aldi and Lidl did in the aftermath of the 2009 recession. With British families struggling financially, these German discount grocers hired top-quality staff to rethink the discount stores for the British market. The managements were set ambitious targets for sales and market share growth. The remarkable result is shown in the leap from 5.1 per cent to 14.3 per cent market share between them.

Entering or exiting markets

Sales of cosmetics in China in 2020 were more than 340 billion RMB (£38 billion), up dramatically since 2010. More than a tenth of the Chinese market was made up of imports. So, for a business such as UK-manufactured Rimmel, entering the Chinese market would be a bold but logical objective. Entering a new market is bound to be expensive as it is likely to involve heavy spending on advertising.

Exiting markets is also sometimes necessary. Morrisons needed to exit the convenience store segment of the UK grocery market because it didn't have the time or the money to take on Tesco and Sainsbury's in that sector. It wisely exited the market by selling up.

Growing or reducing the workforce

In 2019, Marks & Spencer announced that it would close 120 of its shops by 2024. This was expected to save the business hundreds of millions of pounds a year at a time of a sharp switch towards shopping online. This would lead to a significant reduction in the number of Marks & Spencer staff and therefore the salary bill.

In different circumstances, increasing the size of the workforce may be an important part of how to achieve a growth objective. On a random day in August 2021, games software business Codemasters had 27 job vacancies available on its website under the heading: 'Search for your perfect job'. Having enjoyed a couple of excellent years of sales growth, the company wanted to expand its new games development programme and needed new people to help.

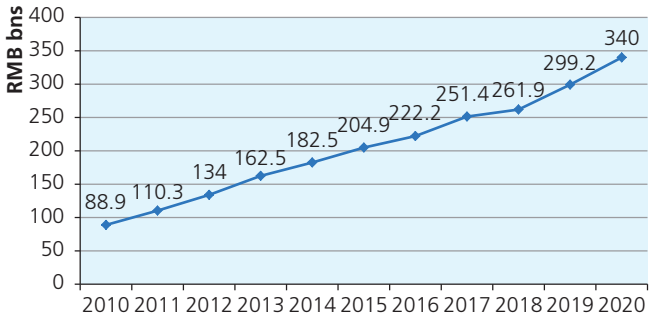


Figure 32.1 Sales of cosmetics in China, 2010–20 (Source: National Bureau of Statistics, China)

Talking point

How might Tesco's appointment of a woman chief executive (for the first time) affect the aims and objectives of the business?

Increasing or decreasing the product range

There are only two ways to grow organically: get customers to buy more of your existing products or hook them into buying new ones. When lockdown

stopped people going to offices in 2020–21, ASOS saw the opportunity to sell new ranges of casual leisurewear. Sales of office clothes and partywear slumped, but leisure and athleisure sales boomed.

It is also important to see the possible benefits from reducing the product range. If you're offering customers 15 models of bicycle, they're not only expensive to produce but it is also likely that customers struggle to decide which one they want. For decades Coca-Cola was proud to say that it offered one bottle of one product at one price (the original glass bottle of Coke). It came to choice later and more reluctantly. A tight product range has every chance of being highly profitable.

> Times and conditions change so rapidly that we must keep our aim constantly focused on the future.
>
> *Walt Disney (1901–66)*

Revision essentials

Entering markets: when a company decides to open up in a market it hasn't been in before, for example Walkers launching cereal bars.

Exiting markets: choosing to leave a market, probably because it was loss-making and looked set to continue.

End of chapter exercises

1 Why might a business change its objectives in response to a boom in demand for its products?

2 Should a large company like Marks & Spencer be required legally to give a substantial notice period before making its staff redundant? Explain your reasoning.

3 **(a)** Using Figure 32.1 on page 173, calculate the percentage increase in sales of cosmetics in China between 2010 and 2020.

(b) Between 2010 and 2020 prices rose in China by 30 per cent. Explain how that is relevant when thinking about sales figures.

4 Read the following extract and answer questions (a) and (b).

After its chief executive left suddenly, AG Foods plc appointed a new boss. She believes that the company must focus on healthier foods and drop two product lines that are exceptionally high in fat and calories. Following that approach will result in 120 job losses but ensure that the company is seen as being serious about good nutrition. Her main focus is: 'to create certainty by focusing on brands we can be proud of, not on products that might embarrass the company'.

(a) Explain how leadership changes might affect the aims and objectives of a business such as AG Foods.

(b) Discuss how AG Foods' stakeholders might feel about the change in the aims and objectives proposed by the new boss.

Practice questions

Dazzling growth for Salt

A catering business has invested £40,000 in moving to premises three times the size of its existing site in Leeds. Salt's Catering launched in 2012 and has now moved to a 4,200 sq ft unit at Wellington Road Industrial Estate. It delivers to a corporate base across Leeds and Bradford, and also provides catering for weddings, conferences and private functions.

Bruce Salt, a director at Salt's Catering, said: 'One of the main causes of our growth has been the way we have moved into new markets. While corporate catering is still the lifeblood of the business, in the last couple of years we have teamed up with venues across Yorkshire to provide catering for weddings and conferences, while also securing a large proportion of our work through private functions too.'

He added: 'The new unit gives us the scope to grow by another 500 per cent. We are looking to invest an additional £50,000 in new equipment and building improvements so we really feel we are in our strongest position yet to take on bigger orders, more ambitious events and larger catering contracts.'

Source: www.thebusinessdesk.com, 28 January 2015

Total: 20 marks

1 Outline one way in which the £50,000 of extra investment could have been financed. (2)

2 Outline one reason why Salt's Catering has had to evolve so quickly. (2)

3 State the sum of money Salt's Catering plans to spend on new equipment and building improvement. (1)

4 Analyse how Bruce Salt's aims and objectives have changed over time. (6)

5 Bruce Salt's next big question is whether to expand into new markets in EU countries. He sees two options:

- Option 1: Open new sales outlets in France and Germany, relying on the good English spoken widely by French and German businesspeople.
- Option 2: Hire a new team of French- and German-speaking sales staff.

Justify which **one** of these options he should choose. (9)

33 Business and globalisation

Globalisation is the tendency for economies to trade increasingly with each other, creating opportunities for international and multinational companies. Exports (and **imports**) represent a much higher percentage of national income than was true 50 years ago. Years ago, one company (British Leyland) had more than 50 per cent of all the car sales in the UK; today it is difficult to get a ten per cent share of the market because there is so much tough competition from round the world. Today, car buyers enjoy terrific product quality, reliability and value for money, but far fewer Brits are employed in car manufacturing.

In the 1960s, The Beatles were a global music phenomenon, but also they recorded versions of their hit songs in German and French to meet local needs. Adele's best-selling album *30* was only recorded in English but sold worldwide. Markets have become far more globalised (and English is a global language). Globalisation worries those who fear immigration and fear competition, but it is great for those who feel that they have the skills and the ideas to succeed anywhere.

> Globalisation has enriched the planet beyond belief, leading to ever-greater demands of perfection. And, thanks to 24/7 communications, we all instantaneously know when these expectations aren't met.
>
> *Victor Hanson, US commentator*

The impact of globalisation on business

Imports

Imports are goods or services bought from overseas companies. There are broadly three types of imports:

1. Goods that have to be bought from abroad because we don't grow or make them, such as olive oil (made from olives, which only grow in hot climates).
2. Goods that require a lot of labour time, and are therefore much cheaper to make in a country such as Bangladesh, where wages may be only 25p per hour. Clothes are a good example.

Clothes are imported as production abroad is cheaper

3 Goods that are made in the UK and elsewhere, largely using high technology and high skills, meaning Britain is competing with equally developed countries such as Germany, France, Italy and the USA. In 2019, 88 per cent of cars sold in Britain were imported. Fortunately car producers such as Nissan and Jaguar Land Rover also export many cars from the UK.

Competition from overseas

In the British car market, the toughest competition comes from Germany. VW Audi, BMW and Mercedes are powerhouses of our car market. Their success is nothing to do with wage rates, as German wage costs are higher than in the UK. The success of their competitive push has been down to heavy investment in new product development and product design. Many British families aspire to have an Audi or a Mercedes. The same applies in markets such as games consoles and washing machines – we import because consumers have chosen foreign producers over ours.

Buying from overseas

In addition to consumer goods bought from overseas, many British producers buy supplies from abroad. Cars contain thousands of components; in the case of British-made cars, more than 50 per cent of the components are imported. So, even a British-built car is not really a British car. Jaguar Land Rover has said that it would love to buy more components from Britain, but there are just not enough component manufacturers here – so they have to import.

> It is clear our nation is reliant upon big foreign oil. More and more of our imports come from overseas.
>
> *George W Bush, former president of the USA*

Exports

Exports are UK-produced goods or services bought by an overseas customer. Every export sale represents income flowing into the UK, which helps to pay for the country's import bill. Although only ten per cent of the UK economy is generated by manufactured goods, about 50 per cent of exports are manufactured. Services generate the other 50 per cent of exports, such as banking, tourism, insurance and the creative arts, from music to computer games software.

To sell to overseas markets successfully, our exporters need to:

- keep their costs down in order to keep prices down
- produce original, well-designed and well-made items (or well thought through services)
- deliver on time and provide excellent service and after-sales service.

Changing business locations

In 2019, Unilever closed its factory in Norwich, switching its Colman's Mustard operation to Burton-on-Trent, and production of sauces to Germany. Colman's had been producing in Norwich for 160 years, but for no longer. The immediate benefit to the company was to reduce overall production

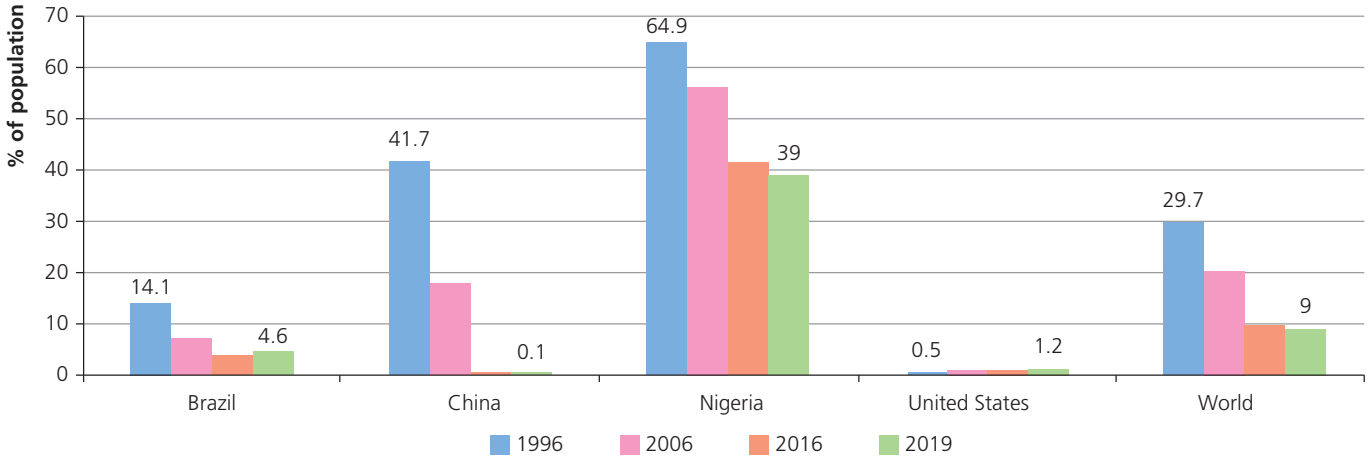


Figure 33.1 Poverty: percentage of population living on less than $1.90 a day (Source: World Bank)

Table 33.1 Trading blocs and their features

Trading bloc name	Trading bloc members	Main features of the bloc
EU (European Union)	27 members (after Britain's withdrawal) led by Germany and France	Free movement of goods and labour with a single market backed by common, EU-wide legislation
ASEAN (Association of South East Asian Nations)	Ten members including Thailand and Vietnam, but excluding China	Free movement of goods; started in 1965 with five members; members have enjoyed high economic growth
NAFTA (North American Free Trade Association)	USA, Canada and Mexico	Free movement of goods; just three members: two rich and one much less so (Mexico)

capacity, and to cut the fixed costs involved in the Norwich factory. For the staff, though, there is no way people could commute to Burton or Germany, so redundancies were inevitable. But it would be unrealistic to expect every factory to stay unchanged over the years. When there are shifts in global demand, companies must respond.

Talking point

The former head of the World Trade Organization, Pascal Lamy, has said that 'Globalisation is incredibly efficient but also incredibly unjust.' Look at Figure 33.1 (page 177) and consider whether it supports this view.

Barriers to international trade

Tariffs

Tariffs are taxes imposed on imported goods. China places tariffs on imported luxury cars of 15 per cent. So a £400,000 Rolls-Royce made in Britain faces a tax of £60,000 when it arrives in China. Many western car companies get round the tariff by setting up factories in China, but Rolls-Royce remains firmly British.

The effect of tariffs is to:

- 'protect' home producers by making imports artificially expensive, which is likely to make the imported goods less attractive to the customer
- increase the cost of living for consumers, effectively reducing a household's living standards. If import prices go up, everyone's pay packet buys a bit less, making people worse off
- get in the way of globalisation: wide use of import tariffs would encourage people to buy home-produced goods and therefore stop the growth of global trade.

Trade blocs

A **trade bloc** is an agreement between countries to trade freely with each other behind a tariff wall that discourages outsiders. For 40 years Britain was a member of the world's biggest trading bloc, the EU. Leaving in 2021 made the UK one of the outsiders. This might damage our exports, and therefore our economy in general, but is especially worrying for our manufacturing companies. Some believe there will be new opportunities for Britain outside the EU, however.

The world's largest trading blocs are described in Table 33.1.

How businesses compete internationally

Use of the internet and e-commerce

For small businesses, e-commerce provides the opportunity to sell globally without the cost of setting up operating divisions worldwide. This makes it possible for a new business to sweep to global success on the back of one trend or even a short-term fad. This might be a clothing fashion or perhaps a new celebrity-endorsed diet.

For larger businesses, the use of the internet/e-commerce may provide a dynamic business opportunity, or simply become a minimum requirement for business success.

> The Chinese government clearly sees the internet and mobile innovation as a major driver of its global economic competitiveness going forward.
>
> *Rebecca MacKinnon, CNN journalist*

Changing the marketing mix to compete internationally

If a business changes from operating only in Britain to operating internationally, it would need to rethink its use of each of the 4Ps.

- Product: for a car such as BMW's British-produced Mini, **competing internationally** means that the car has to be offered with left-hand drive and with the flexibility to provide the safety systems and exhaust/pollution systems to fit local laws in a variety of different countries. This adds to the total costs per unit and, therefore, needs to be recovered by charging a slightly higher average price.
- Price: the Mini has a reputation for being cool and classy, but that reputation may be stronger in some countries than others. If it is especially strong in the USA, for instance, the Mini should perhaps be priced higher there than in other countries. Doing so will make it possible to charge a lower price where local competition is especially fierce.
- Promotion: few companies manage to run just one advertisement globally. The advertising image often needs to be different in different countries because of cultural differences. So, this aspect of the mix may have to be changed to reflect cultural differences.
- Place: while Britain is highly advanced in e-commerce, others are less so. Figure 33.2 shows the data for different regions of the world. In 2021, about 25 per cent of Britain's retail sales came from e-commerce. As Figure 33.2 shows, it was among the world's most developed e-commerce markets. For a British company, a move into South America or Africa would require a different attitude to distribution/place.

> German export successes are not the result of some sort of currency manipulation, but of the increased competitiveness of its companies.
>
> *Wolfgang Schäuble, German finance minister*

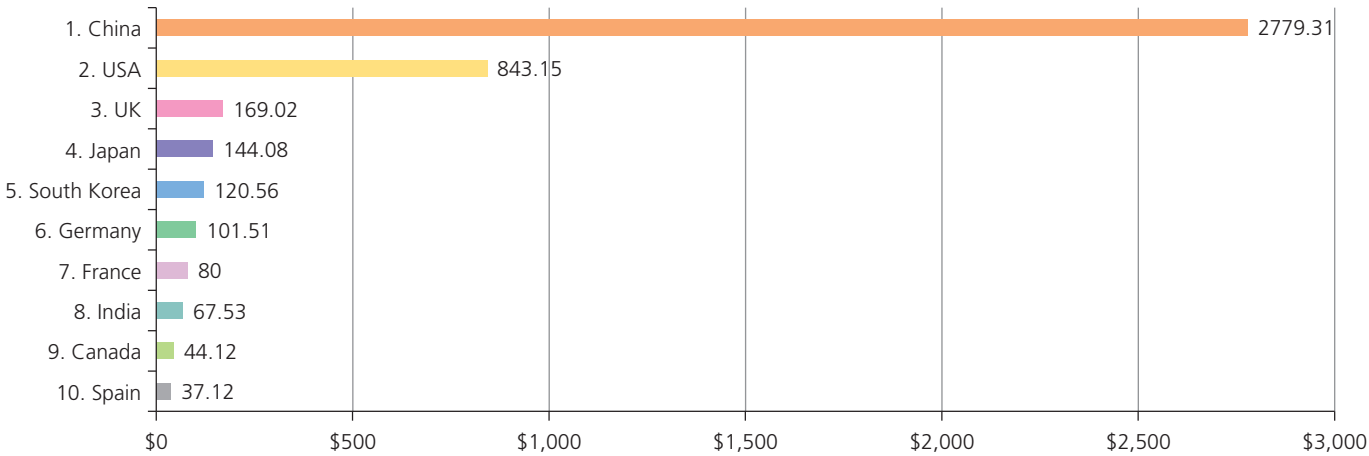


Figure 33.2 Top 10 countries ranked by retail e-commerce sales, 2021 (in US $ billions) (Source: *eMarketer*)

Drawing the right conclusions

Globalisation is often regarded as a bad thing, especially by those who seem to be losing out, but most companies love the opportunity to take a successful product or service and offer it to the world. Costa has done this brilliantly in China – developing the second-biggest coffee chain (behind Starbucks). Years ago that would have been impossible. Globalisation also implies more opportunities for bright people to be able to work anywhere they choose – perhaps Tokyo for a few years, followed by New York, before returning to Britain. But with attitudes changing in the USA and Brexit in Britain, perhaps the steady growth of globalisation is coming to an end.

Revision essentials

Competing internationally: finding a way to succeed against rivals from overseas.

Free trade: trade between countries with no barriers, for example no tariffs.

Globalisation: the increasing tendency for countries to trade with each other and to buy global goods, such as Coca-Cola, or services, such as Costa Coffee.

Imports: goods or services bought from overseas.

Tariffs: taxes charged only on imports.

Trade blocs: a group of countries that have agreed to have free trade within external tariff walls.

End of chapter exercises

1 What point is being made in the text on page 176 about The Beatles and Adele?

2 Using Figure 33.1 on page 177, what might explain the dramatic fall in poverty in China over this period of globalisation?

3 The EU is unusual for making the free movement of labour a key part of the trade bloc. Explain why businesses may favour the free movement of labour.

4 **(a)** Look at Figure 33.2 on page 179. Calculate whether or not China's online sales were greater that year than the next nine countries added together.

(b) From your calculation, how should a UK e-tailer such as Boohoo respond?

5 Read the following extract and answer questions (a) and (b).

Halloween is a global phenomenon, as big in Japan and Vietnam as the USA or the UK. It didn't used to be that way. It wasn't even much of a thing in Britain. But globalisation has spread this US marketing bonanza worldwide. No one knows how big the global market has become, but a trade estimate of $16 billion may be about right. For 2021, Cadbury's owner Mondelez planned Oreo Spooky Bags, Cadbury Goo Heads (monster-themed Creme Eggs) and Cadbury Skeleton Fingers. Exactly the same products and packaging were used worldwide. Cadbury novelties such as Goo Heads were priced higher in Japan than the UK, but advertised in a much softer way. The Japanese do not want their children scared.

(a) Explain how Cadbury has changed its marketing mix to compete internationally.

(b) Discuss whether the globalisation of Halloween sweets is a good or bad thing for chocolate producers such as Cadbury.

Practice questions

How can you sell jeans for £5.99?

'Jean genie Lidl magics up £5.99 denims', shouted the headline in a newspaper last weekend as it extolled the brilliance of the cut-price supermarket chain in once again undercutting its rivals. The German retailer, it explained, was continuing its assault on the traditional supermarket giants by targeting the high street fashion-conscious with jeans selling for an astonishing £12 less than a similar pair in Tesco.

How could these retail wizards do it? The unchallenged line from Lidl was that its huge buying power was the answer. It was just good at doing deals. But let us be clear. This is not magic. It is not Harry Potter making these jeans, it is a young woman in a factory in Bangladesh and one of the main reasons they are so cheap is that workers like her are paid as little as 2p for every pair they make.

Still, £5.99 is quite an achievement when even Primark – no slouches in the cost-cutting field – have only managed to get their lowest price down to £8. So how do they do it? 'Lidl surprises' is the slogan the supermarket currently uses to punningly flog its wares, but it is no surprise to discover that the firm, like many of the British high street retailers, does much of its clothes shopping in Bangladesh, where the minimum legal wage for a garment worker is 23p an hour.

What goes into the cost of a pair of jeans?

- Material: £2.40; zip 10p; buttons 4p; rivets 1p; label 7p; thread 19p
- Washing and checking: 47p
- Labour: 2–9p per pair (23p an hour and output of ten pairs of jeans per hour = 2.3p per pair)
- Shipping: 80p

Total: 20 marks

1. Outline one reason why a government might set a minimum legal wage. (2)
2. State the minimum hourly wage for a garment worker in Bangladesh. (1)
3. Outline one reason why Lidl might want to offer jeans at £5.99 a pair. (2)
4. Analyse how the case of Lidl's £5.99 jeans could be used to criticise globalisation. (6)
5. Lidl enjoyed huge sales of its £5.99 jeans, but is wondering what to do now that sales have slipped back. Management sees two options:
   - Option 1: Push to get a new supplier in Bangladesh to make jeans that can be sold for £4.99.
   - Option 2: Make slightly better jeans and charge the Primark price of £8.

   Justify which **one** of these options the management should choose. (9)

Lidl sells jeans for £5.99

34 Ethics and business

All businesses have to follow legislation and failure to do so will result in their being prosecuted, but this is not the same as unethical behaviour. Being legal means operating within the law; being ethical means doing what is right.

Ethical behaviour covers every aspect of business, including who a business buys supplies from, how it treats its employees, how it acts towards its competitors, the impact it has on the environment and the impact it has on its local community.

And what does it mean to be unethical? Here are examples of unethical business activity:

- US company Purdue promoted a drug that was at the heart of the opioid crisis that cost more than 100,000 US lives. The drug was promoted as a way of getting off heroin-related drugs, but was actually highly addictive. Profits running to billions of US dollars were made until the government clamped down.
- A British pharmaceutical business came to an agreement with another company, allowing it to push the price of hydrocortisone tablets up 10,000 per cent, from 70p to £88. The bosses involved would have known that the main buyer of these tablets was the NHS. So they were rigging the market in order to exploit all of us.
- In 2020, a number of British musical instrument-makers were fined, having been caught fixing the prices of instruments such as guitars and pianos. This would have made it harder for less well-off kids to afford an instrument.

> Ethics is nothing else than reverence for life.
>
> *Albert Schweitzer, philosopher*

What about profit?

A business may have to accept lower profits when behaving in a socially responsible way. In January 2014, Lidl became the first UK grocer to remove sweets from all its checkouts. It means less chocolate slipped casually into the basket, and earned them the thanks of many parents. The decision may lower profits in the short term, but it was based on what was right for the customer and the long-term reputation of the business.

Companies have to make a large enough profit to pay off loans, pay dividends to shareholders and finance new growth initiatives. But as long as those needs are covered, a business should want to make decisions that are morally right.

How ethical considerations influence business activity

One view is that ethical considerations are becoming a stronger part of business decision making. People with that view might point to the efforts made by Mars to reduce the calorie and fat level in a Mars bar or a Snickers. They might also be impressed by the array of organic, recyclable and 'natural' products on supermarket shelves. The same optimism could be used to praise companies that are operating more apprenticeship schemes and are appointing more women and ethnic minority candidates to senior management posts.

Unfortunately, pessimists can make a strong case too. While most people were focused on keeping their families safe during the Covid-19 pandemic, some found ways to make fabulous profits supplying PPE to the NHS. And as for companies such as Mars making chocolate bars ever-smaller, it can be argued

that they're just encouraging people to buy more 'Duo' bars and more 'sharing' bags. Recent years have seen a series of awful business scandals, including companies such as Volkswagen of Germany and GlaxoSmithKline of Great Britain. This doesn't seem to be a time to be complacent about improvements in ethical standards. Even the **fair trade** movement has been hit by companies such as Cadbury and Nestle cutting their connections and switching to lower standards of welfare for cocoa farmers.

What's not in doubt, though, is that modern businesses are finely tuned towards the latest consumer concerns. If people want foods free from gluten, fat or dairy, companies will respond quickly. Does that make them ethical? Not at all – it simply means that they want to gain sales wherever they can. Whether, like Warburtons, they are selling crumpets with or without gluten doesn't matter to the company. Businesses just want to be responsive to changes in customer tastes (that is, give the customer what they want) regardless of whether it is right or wrong.

Possible trade-offs between ethics and profit

Businesses suggest that they are naturally ethical because high standards mean high consumer reputation. This generates the profits to keep standards high, as Figure 34.1 shows.

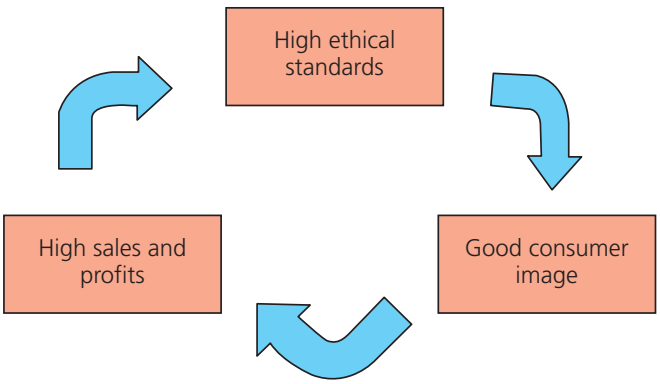


Figure 34.1 The trade-off between ethics and profit

Unfortunately, that often proves not to be the case. A **trade-off** occurs when a business chooses one course of action instead of another. It is an either/or moment. A business might happily follow green policies when they save the company money, but what if an ethical approach would hurt profit? What would a business do at that point? Go ethical or go profitable?

> A business that makes nothing but money is a poor kind of business.
>
> *Henry Ford, father of all modern manufacturing*

Go ethical

Not that many years ago, cigarette companies were among the country's biggest advertisers. Many advertising agencies made a good living working on these multi-million pound campaigns. One agency refused to deal with tobacco companies, however. One of the founders of Allen, Brady & Marsh had seen a loved-one die of cancer, so the decision was taken to never deal with cigarettes. This ethical stance impressed no one in the industry at the time, so the decision was entirely for **ethics** at the expense of profit.

> Being good is good business.
>
> *Anita Roddick, founder of The Body Shop*

Pressure groups

A pressure group is an organised group of people that seeks to influence government policy, legislation and business behaviour. Pressure groups include Friends of the Earth (environmental), Amnesty International (which campaigns for human rights) and Searchlight (which aims to combat racism and prejudice).

If a business behaves in a way that a pressure group disagrees with, the media may turn against the company. Nike suffered serious sales declines when its expensive trainers were revealed to be produced by low-wage Asian factories. Pressure groups can embarrass companies and damage the company's image. This could lead consumers to boycott the business, damaging the profits and therefore upsetting the shareholders.

Pressure groups and the marketing mix

If a pressure group targets a particular business, the business has little alternative but to respond. This may involve product changes. In response to a sustained attack by pressure group Lynx to the use of real animal fur, many clothes manufacturers switched to 'faux fur' products. This should enable the manufacturers to cut the selling price, as the cost of fake fur is much lower than real fur. It might also lead to a switch in retail distribution: many shops refuse to sell real fur, but fake fur can be sold by anyone. Other important business-related pressure groups include:

- Greenpeace, an international pressure group focused on the environment
- Campaign Against Arms Trade
- Corporate Watch, which tries to hold businesses to account for unethical behaviour.

Talking point

Would you regard Extinction Rebellion as a pressure group or a political movement?

Drawing the right conclusions

In business it is easy to confuse ethics with '**ethical considerations**'. Ethics is the real thing – doing what seems right morally. 'Ethical considerations' may mean no more than thinking about how to make money out of the appearance of being ethical. Proof that a decision is ethical comes when the business accepts a hit to its profit. It is tough for a business to do that, but sometimes it will find long-term benefits in terms of customer image and when trying to recruit bright young people.

Revision essentials

Ethical considerations: thinking about ethics, which may lead to morally valid decisions or may lead to the manipulation of customer attitudes, that is, pretending to be ethical.

Ethics: weighing up decisions or actions on the basis of morality, not personal gain.

Fair trade: a social movement whose goal is to help producers in developing countries achieve better trading conditions and to promote sustainability. It ensures that the price paid is high enough to allow fair wages to be paid to the workers who produced the goods. Fair trade certification can be found on many products, including KitKat.

Trade-offs: how having more of one thing may force you to have less of another; for example, higher ethical standards may mean less profit.

End of chapter exercises

1 Explain in your own words what is meant by a business being 'ethical'.

2 Briefly explain the possible impact on its profit if:

(a) JD Sports put all its prices up by 10 per cent to ensure that workers making its trainers and clothes are better paid

(b) a car manufacturer stopped producing 4×4 (petrol-hungry) cars.

3 Use the internet to research one of the three pressure groups listed in the text. Outline one activity it has been involved in recently.

4 Explain two potential benefits to a retailer of selling fair trade items.

5 Read the following extract and answer questions (a) and (b).

The Co-op Food supermarkets are built on a foundation of social responsibility, having developed from the co-operative movement started by the Rochdale Pioneers. In 1999, the Co-op made the decision to stock fair trade tea and coffee in all its stores; by 2010, it stocked over 120 fair trade products. Since then the Co-op has won prizes for corporate social responsibility due to its promotion of fair trade products. In 2021, the Co-op announced that its 'fair trade fortnight' would be bigger and better than ever before.

(a) Give two possible reasons for the Co-op making the decision to sell such a large range of fair trade products.

(b) How might receiving awards for corporate social responsibility help the Co-op achieve its aims and objectives?

6 Should Tesco follow the Co-op's example? Explain your reasoning.

Practice questions

Turning £27 into £72 million

Grenade: making sure to get publicity

In 2010, when they started up, Alan and Juliet Barratt saw the balance on their business bank account fall to just £27. Seven years later they sold a majority stake for £72 million. The business they founded – Grenade – now sells in 80 countries and is still growing strongly. The products have transformed the high-protein snack sector that was once a tiny niche market for body builders.

Table 34.1 Nutrition information for Grenade Carb Killa and Nature Valley Cereal Bar

Per 100 grams	Grenade Carb Killa 60 g, £2.59	Nature Valley Cereal Bar 42 g, 69p
Calories	376	456
Fat	16.0	17.2
Saturated fat	9.2	2.4
Fibre	4.1	5.6
Protein	33	8.1
Ingredients	Milk chocolate with sweetener (25%) (sweetener: maltitol; cocoa butter, whole milk powder, cocoa mass, emulsifier: soy lecithin; natural flavouring), protein blend (calcium caseinate (milk), whey protein isolate (milk)), humectant: glycerol; hydrolysed beef gelatine, chocolate chips with sweetener (8%) (sweetener: maltitol; cocoa mass, emulsifier: soy lecithin; low fat cocoa powder, natural vanilla flavouring), bulking agent: polydextrose; palm fat, white chocolate with sweetener (sweetener: maltitol; cocoa butter, whole milk powder, emulsifier: soy lecithin; natural flavouring), low-fat cocoa powder, sea salt, flavouring, sweetener: sucralose	Wholegrain rolled oats (59%), sugar, sunflower oil, honey (2%), salt, molasses, emulsifier: sunflower lecithin; raising agent: sodium bicarbonate

In an article for *Business Leader* magazine, the couple wrote about their success in building the Grenade brand name: 'Whether people love it or hate it, we've always wanted shoppers to have an opinion and a reaction to our brand. Grabbing attention was a reason why we chose bold brand and product names, strong colour palettes and disruptive stunts from the start. To create a strong identifiable brand, you can't afford to be too worried about what others think – particularly in competitive retail markets where you have about five seconds to grab people's attention while they're in a shopping aisle.'

The name itself was an attention grabber, and among their marketing stunts was to bring an army tank on to a display stand at a fitness exhibition. It received huge media coverage. Later they went further, taking the tank on to the streets of London to get further publicity for their 'war on unhealthy snacking'.

Whether Grenade products are really healthier is debatable. Nature Valley Cereal Bars are pretty cheap, and have an ingredients list of quite healthy, natural products. Grenade's Carb Killa bars, by contrast, are astonishingly expensive and packed full of artificial sweeteners and strange stuff (humectant, palm fat).

But Alan and Juliet showed brilliant understanding of their market. According to *The Grocer* magazine, grocery sales of Carb Killa bars rose from £1.1m in 2018 to £7.4m in 2019. Those figures will be on top of all the sales they make in gyms and health clubs. Their target market of body builders are willing to pay high prices for products that are believed to help them build their muscles. And if others buy the protein bars in Tesco and simply put on weight rather than muscle – that all helps with revenue and profit.

Total: 24 marks

1 Calculate the percentage change in sales of Carb Killa bars in 2019 compared with 2018. (2)

2 Analyse the effectiveness of the promotional strategy used by the Barratts. (6)

3 (a) Using the information in Table 34.1, calculate the difference in the price per gram for customers buying Carb Killa compared with Nature Valley Cereal Bars. (2)

(b) Outline one factor that may have influenced the pricing strategy used for Carb Killa. (2)

4 Evaluate whether the Barratts made the right trade-offs between ethics and profit. (12)

35 Environment and business

In 2021, dramatic rainfall in Germany caused floods that killed 200 people, with another 150 missing, presumed dead. In the same week, unprecedented rainfall in London led to substantial flooding, affecting homes and shops. Elsewhere, California faced widespread wild fires as a result of heatwaves and drought. More than 500,000 acres of forests were destroyed, as were many small towns. A TV interview showed a distraught shopkeeper looking at her ruined livelihood. And in Siberia, Russia, wild fires became a normal occurrence. Whether or not these incidents were the result of global warming, there is no doubt that the environment matters to business.

How do environmental considerations affect business?

Environmental considerations can have both short- and long-term effects on a firm.

In the short term, the environment can be an important stakeholder issue. The environment affects us all as residents and shoppers. The Mayor of London reports that around 4,000 Londoners die each year due to breathing problems made worse by air pollution. In Manchester, around 1,000 die annually from the same cause. Many of the problems can be traced back to over-purchasing of diesel cars. Now, opportunities arise from greater investment in cycle lanes and the provision of more charging points for electric cars and bikes. This creates jobs, but also opportunities for entrepreneurs.

In the longer term, firms need to help to overcome the challenge of global warming. More and more governments have committed to net zero carbon emissions by 2040, 2050 or 2060. This gives rise to, possibly, millions of jobs in the UK in sectors such as offshore energy generation (from wind) or the replacement of gas boilers with modern heat pumps.

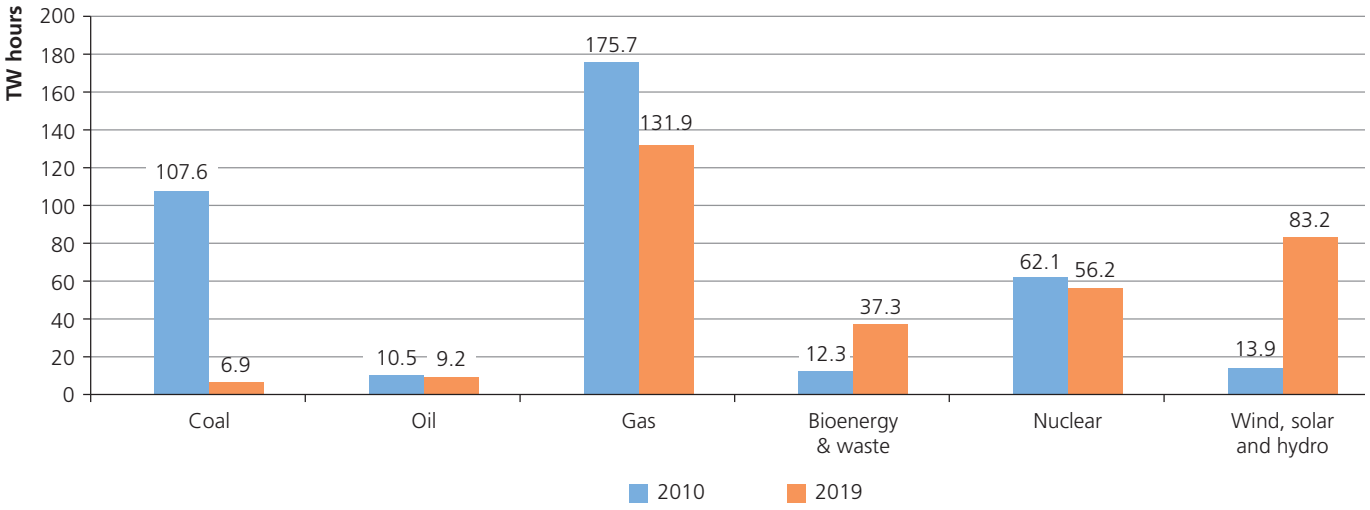


Figure 35.1 UK generation of energy (terrawatt hours), 2010–19 (Source: UK Energy in Brief 2020)

Some British companies are taking steps to cut their carbon emissions. This is partly to help the government meet its international target of CO_2 reduction, but also because companies need to be seen to be responsible. This can be important to a company's public image and can help when recruiting young, bright staff.

Natural energy sources such as coal and gas are being used up and energy companies have to look at alternative fuels for the future. Electricity companies are anticipating growing markets for wind power and for more energy-efficient appliances. Figure 35.1 (page 187) shows the big increase in 'alternative energy' supply in Britain between 2010 and 2019. Unfortunately, even in 2019, these natural, renewable sources of clean energy were outweighed by carbon-generating gas.

Global warming could change other industries, too. Many environmental scientists believe that, even if we do reduce emissions, the earth will still warm by several more degrees in the next few decades. That could cut agricultural harvests, raise sea levels and bring more extreme weather.

For businesses, this presents both threats and opportunities. Insurers may face more floods, storms and other disasters. Farmers must adjust crops to changing climates. In the south of England, wine producers are having more success since their crop is now rarely affected by frost.

> I think the environment should be put in the category of our national security. Otherwise what is there to defend?
>
> *Robert Redford, actor*

Sustainability

All manufacturing requires resources. Plastics, paints and detergents are made from oil, steel requires iron ore and coal, and paper is made from wood. Note the difference, however. Wood is sustainable: as you chop down one tree you can plant another.

The world need never run out of trees → wood → paper.

Every gallon of petrol used today is irreplaceable

Oil, iron ore and coal are very different. The oil used today has been formed underground over the last 10–160 million years. So, every gallon of petrol used today is, in effect, irreplaceable. Oil is a youngster compared with coal, which was formed 300 million years ago! Minerals such as iron ore (or copper or lead) are even more irreplaceable, as the earth cannot remake them.

The point is, then, that using certain resources is a once-only exercise. They are not sustainable. For businesses that depend on these items, careful use is essential. A plumber should never want old copper pipe to end up in landfill, because it could and should be recycled.

Sustainability can be improved by careful business decision making. Making something from plastic means using up unsustainable oil; make the same thing from wood and the item becomes sustainable, because trees can be replanted.

Talking point

Are businesses to blame for global warming?

Trade-offs between the environment, sustainability and profit

It should be natural for a business to see sustainability and profit going hand-in-hand. To keep making profits year after year, Nissan UK needs raw materials and components to keep flowing into its factories. If something 'runs out' then the business cannot function.

Some businesses are based entirely on the **environment**, such as the makers of wind turbines or the operators of solar power 'farms'. Others find ways of doing their best to operate ethically in relation to the environment. A third batch operate 'greenwash'. This means operating as normal, but dressing up their actions as if they care about green issues. This type of business finds one part of their normal activities to dress up as a huge environmental commitment. For example, a maker of aluminium cans proudly boasts 'zero waste'. In fact the company has no waste because aluminium is expensive and it makes business sense to reuse any waste materials. It has nothing to do with the environment. Greenwash should be an embarrassment to all in business, but is rarely singled out as being a hypocritical action.

Today, with global sales of electric cars doubling each year, there is huge pressure on 'rare earth' metals. These metals, such as terbium and gadolinium, have long been needed for military aircraft, but now stand at the centre of Tesla's progress. Electric cars need super-powerful batteries, and that means rare earth metals. At present, China controls 80 per cent of the world's supply, though the USA has vowed to find a way to boost its own supplies. As with other metals, the earth has a limited supply, but sustainability can be achieved by careful recycling.

> Regulatory failings mean that the cost of breaking the law is far below that of obeying it – businesses are happier to pay fines than to control pollution.
>
> *Ma Jun, Chinese environmentalist*

Pressure groups, the environment and the marketing mix

Companies have learned to be clever about **environmental considerations**. Many shops, charities and brands offer a 'bag for life', priced anywhere from 99p to £19.99, and almost every modern brand makes some environmental claim. For pressure groups such as Greenpeace, it can be difficult to find a chink in the armour of many companies. Only occasionally does a huge slip occur, for example when Volkswagen was caught cheating on exhaust emissions on its diesel cars. Continuing pressure from Greenpeace and Friends of the Earth encouraged government fines and consumer compensation claims that had cost Volkswagen £30 billion by 2021. Hopefully that will stop any car firm from trying to cheat emissions tests in future.

Many modern companies think carefully about their environmental image and adjust their marketing mix accordingly. This might lead a toilet roll producer to plan a marketing mix that covered:

- product: made from recycled sources; for every tree cut down we plant another two
- promotion: 'kind to your skin; kind to the planet'
- price: a small price premium to reflect the presumed extra costs
- place: 'we produce in the UK, cutting delivery miles and cutting our carbon footprint'.

Drawing the right conclusions

As with ethics, the key requirement with the environment should be to 'do the right thing'. In fact, all western countries have found it necessary to introduce tough environmental legislation to get firms to behave. The incentive to achieve profit has often outweighed the desire to do good. Does that mean that all firms are bad? Not at all.

Marks & Spencer has run its 'Plan A' programme of environmental improvement for nearly 15 years – even though it is not widely known. But when companies shout loudly about doing the right thing, it is sensible to wonder whether this is greenwash rather than actual green ethics.

Revision essentials

Environment: the condition of the natural world that surrounds us, which is damaged when there is pollution.

Environmental considerations: factors relating to 'green' issues, such as sustainability and pollution.

Sustainability: whether or not a resource will inevitably run out in the future; a sustainable resource will not.

End of chapter exercises

1 **(a)** Use Figure 35.1 on page 187 to calculate the percentage increase in energy produced from wind, solar and hydro sources between 2010 and 2019.

(b) Explain the environmental benefit that should result from this increase.

2 Explain why 'sustainability' is important to businesses and society.

3 Outline how two different UK businesses might benefit from warmer temperatures in Britain.

4 Explain how your school can change to become more environmentally friendly.

5 Since being caught cheating in diesel car emissions tests, Volkswagen has changed direction, switching from diesel to electric cars. Outline two difficulties a business may face in making such a change.

6 Read the following extract and answer questions (a) and (b).

In 2007, Marks & Spencer introduced its 'Plan A' strategy for improving its environmental performance. Each year it reports on its environmental achievements and may set out new targets for the future. In 2021, it included the following commitments:

- 100 per cent of priority raw materials will be sustainably and ethically sourced, with all policies published by 2025.
- Convert all our textile raw materials to sustainably sourced and traceable alternatives by 2030.

Source: Marks & Spencer Plan A Report 2021

(a) Explain two possible reasons why Marks & Spencer is pursuing its Plan A.

(b) How might consumers respond to information about Marks & Spencer's sense of environmental responsibility?

7 Marks & Spencer is closing stores at a likely cost of hundreds of jobs in the UK. Should it re-think its focus on Plan A?

8 Which two of the following environmental factors should be the biggest concerns for an entrepreneur thinking of setting up a new vegan cafe in a town centre?

(a) The risk of local flooding in an era of global warming and therefore more dramatic storms.

(b) The rising concern that meat-eating will create an upsurge in supplies of plant-based foods.

(c) That rising sea temperatures may lead to lower catches by fishing fleets.

(d) That travelling into towns may become less popular because of high congestion-zone charges.

(e) That the expansion of deserts in hot countries may lead to increasing migration to developed countries.

Practice questions

Waste mis-management

In April 2016, one of the biggest waste-management companies in the South East was given a record fine over illegal treatment of hazardous material including asbestos at its huge Willesden depot. Powerday, run by London Irish rugby club co-owner Mick Crossan, disposes of waste for major clients including Barratt Homes, Berkeley Homes and Carillion.

The firm was ordered to pay more than £1.2 million at Harrow Crown Court for offences related to two separate cases which, combined, saw more than 17,000 tons of waste deposited and stored illegally. The materials came from across London and from a power station in Nottinghamshire. The record fine came under tough new sentencing guidelines for environmental crimes. The case was brought by the government-financed Environment Agency, which checks that businesses stick to environmental laws.

Total: 20 marks

1 Outline one reason why the court decided on such a high fine for Powerday. (2)

2 Analyse why the government pays for an agency to check that businesses stick to environmental laws. (6)

3 Evaluate whether Powerday found the right trade-off between profit and the environment. You should use the information provided as well as your knowledge of business. (12)

Practice questions

Plant-based money trees

Beyond Meat burgers

In the year to June 2021, the UK market for meat-free grocery products was £648.4 million, 20.2 per cent up on the previous year. Demand for alternatives to meat has made this a very exciting area for entrepreneurs. US firm Beyond Meat is expected to float on to the New York stock market for more than $10 billion later in 2021. There are many UK brands with sales in the range of £5 million to £10 million a year, which are not yet big enough to attract the interest of big companies. But in April 2021, Dutch meat-free business Vivera was bought for £296 million – giving huge profits to its shareholders.

Within the meat-free sector, 2021 saw a big rise in sales of pies and pastries, with sales up by £16.8 million, up 34.6 per cent on 2020. Only ready-meals saw a dip in sales, as lockdown Britain saw a switch towards cooking from scratch. Companies such as Heck and Dopsu are hoping to cash in on the desire by investors to get their share of this sustainable, on-trend marketplace.

Total: 20 marks

1 Outline one reason why a growing business such as Beyond Meat might choose to float its shares on the stock market. (2)

2 Analyse why the market for meat-free grocery products is attracting interest from investors. (6)

3 Evaluate the impact of factors that will determine whether the market for meat-free products continues to grow in the future. You should use the information provided as well as your knowledge of business. (12)

Exam-style questions on Topic 2.1

Don't rush; check your answers carefully.

1 Which **one** of these factors is a long-term environmental concern? (1)

- **(a)** Sustainability
- **(b)** Noise pollution
- **(c)** Traffic congestion
- **(d)** Air pollution

2 Which **one** of the statements below is a reason why the Co-op Bank may have decided not to deal with companies such as manufacturers of cigarettes and weapons? (1)

- **(a)** To concentrate on other types of customer.
- **(b)** To please the shareholders of the business.
- **(c)** Because of ethical concerns.
- **(d)** Because the Co-op Bank sees other customers as more profitable.

3 Which **one** of these factors might lead to an increase in imports to the UK? (1)

- **(a)** A fall in the value of the pound against the euro.
- **(b)** A rise in the competitiveness of UK companies.
- **(c)** A rise in consumer spending in the UK.
- **(d)** Strong growth in the economies of China and the USA.

4 Which **one** of the following is the best explanation of the phrase 'business ethics'? (1)

- **(a)** Focusing new product development on customers' new interest in organic foods.
- **(b)** Making sure to think about the concerns of all the business stakeholders.
- **(c)** Basing strategies on one principle: doing what's right for shareholders.
- **(d)** When decisions and actions are underpinned by moral principles.

5 When a public company takes over a rival, which **two** of the following statements are correct? (2)

- **(a)** It has decided to grow inorganically.
- **(b)** Customers may suffer from higher prices and reduced product choice.
- **(c)** It may struggle to finance this as it has no access to the stock market.
- **(d)** It has decided to grow organically.
- **(e)** Organic growth such as this could be a stepping stone to international success.

6 Which **one** of the following is the best explanation of a 'tariff'? (1)

- **(a)** A way for a government to raise taxes from its successful exporters.
- **(b)** A way for a government to give an unfair advantage to its importers.
- **(c)** A way for a business to encourage foreign firms to buy its products.
- **(d)** A way for a government to prevent imported goods from being too competitive.

7 Which **one** of the following can be called unethical? (1)

- **(a)** Refocusing advertising on a younger age group if sales to date have been disappointing.
- **(b)** Making staff redundant in response to a downturn in company sales.
- **(c)** Advertising a yoghurt as 'great for kids' when it's high in sugar and fat.
- **(d)** Cutting costs without cutting prices.

8 Which **one** of the following means growing organically? (1)

- **(a)** Rejecting chemicals so that ingredients grow naturally.
- **(b)** Growing the business without raising capital externally.
- **(c)** Seeking growth from existing products, not new product launches.
- **(d)** Boosting revenues from within the business, not by take-over bids.

9 Choose **one** reason why a business might want to reduce its workforce. (1)

- **(a)** Because productivity is falling.
- **(b)** Because foreign buyers are cutting tariffs on your goods.
- **(c)** Because customer demand is falling.
- **(d)** Because the business is switching aims from survival to growth.

Now try this discussion question.

10 Discuss whether a growing business could benefit from spending on environmental considerations. (6)

36 Product

At the heart of the marketing mix is the product. The key is to design a product (or service) that matches the needs or wants of your chosen target market. It doesn't matter if over-50s hate the new, red Nike VaporMax as long as under-25s love it. Having identified the target market, companies have to work out customer priorities. A classic way to do that is through the **design mix**.

Design and the design mix

The design mix uses a pyramid diagram to encourage managers to decide on the main design priorities for a new product. Every product needs the right balance between the following factors:

- **Economic manufacture**: making sure that the design allows the product to be made cost effectively; a complex design might add 50 per cent to the manufacturing cost, making the product too expensive for some customers.
- **Function**: the design must make sure that the product works well and works every time. A stunning new car may have its sales undermined if there are doubts about its safety, or about its acceleration. 'Function' means how well does it work?
- **Aesthetics**: how well does the product appeal to the senses? It may work well and be inexpensive to make but look or feel cheap. No one buys an iPhone just because it is reliable and has good battery length – they buy it because it looks beautiful and feels good in the hand.

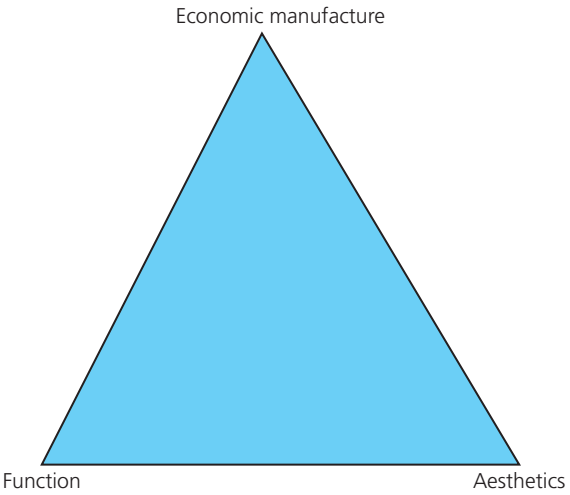


Figure 36.1 The design mix

> Design is not just what it looks like and feels like. Design is how it works.
>
> *Steve Jobs, founder of Apple*

The importance to a business of differentiating the product/service

Product differentiation means making your product stand out from the competition, making people see it as really different and distinctive. This may help the product become a market leader, as *The Sun* is within the British newspaper market; or, like BMW, the distinctiveness may allow high prices to be charged. Table 36.1 on the next page gives some more examples.

Table 36.1 Examples of differentiated products/services

Market	Differentiated product or service
Chocolate	Lindor
Smartphones	Samsung Galaxy Edge
Lipstick	MAC
Cars	Porsche

High differentiation is important because customers can become loyal to something that they see as being different, even unique. Most *Sun* readers buy that paper and that paper alone; most iPhone users would buy a new iPhone if their original one was lost or stolen.

Design plays a crucial part in this process. It starts with a brand logo, such as the Nike 'Swoosh' (the tick). This makes products recognisable in a shop and when worn. In many cases, there are other key characteristics. As a Mercedes sweeps past, it is usually recognisable without seeing the badge on the bonnet. Its designers try to keep all Mercedes looking as if they are from the same family of cars.

A well-designed product will stand out from the crowd and will make the user take pride in using it/wearing it. That will help in achieving product differentiation which, in turn, will make it easier for the producer to set its own price, not really worrying about the prices charged by rivals.

> Strategy is about deliberately choosing to be different.
>
> *Michael Porter, business guru*

Product life cycle

When deciding on marketing approaches, such as pricing or advertising, businesses have to examine sales trends: are sales getting better or worse? One technique a firm can use to do this is the **product life cycle**.

A product's life cycle is the amount of time a business expects the product to sustain profitable sales. Cadbury's Dairy Milk was launched in 1905 and still has many years of profitable life. By contrast, games consoles have a much shorter life cycle: in the week ending 7 August 2021, the PS5 outsold the Xbox One by 79,342 to 2,479 in Europe. Xbox One's life cycle in Europe will soon be at an end.

There are four stages in the product life cycle. These give an idea of where the product is in its lifetime – a bit like a human life.

1. Introduction: First the company spends a lot of time and money researching the product and the market for the product. The product will be tested and market research carried out before it is launched. There will be no sales at this time. The business will be preparing an advertising campaign. At this stage costs are high. The product is then launched and placed on the market. There will be low product sales and small-scale distribution initially. Any advertising will be informative to make people aware that the product exists. The product might be the only one of its kind at this stage, so the selling price will probably be high. At this stage sales are low and costs are high.
2. Growth: At this stage the product becomes known in the market and there will be a wider distribution network. The business will continue with advertising but it will be less frequent than at the product's launch. At this stage customer awareness increases, the price will still be high, and sales and profits start to rise.
3. Maturity: The market may become saturated as 'me-too' or copycat products are launched on to the market. Sales growth flattens out and cash flow improves. Advertising is persuasive and is used to remind the market that the product exists. The business may try to increase promotion in an attempt to maintain market share – money spent on reinforcing the brand image or packaging. Profits are still good. The product is in a highly competitive market and weak brands often disappear at this stage, as they cannot compete.
4. Decline: The product's sales and profits start to fall. The product is no longer offering what customers

want or new technology used by other products has made it out of date. Some businesses will stop their marketing to cut costs but will still make some profits between now and when the product is finally withdrawn. Eventually the product is taken out of production. The last products are often sold at a reduced price, meaning a further reduction in profits. The product is eventually withdrawn from the market.

In reality the length of each stage can vary a lot. Businesses can take actions to prolong a stage, such as heavy brand advertising to try to stop maturity turning into decline. Not all products go through each stage – some go straight from introduction to decline (they are flops).

It is important for businesses to know what stage of the life cycle their products are at so that they can plan the correct marketing mix for the product. Just because a product has reached the maturity stage or even started to decline does not necessarily mean it is the end. Some products will have **extension strategies** launched for them to start to increase sales again, for example by changing the product's design or use.

Talking point

Marketing guru Phillip Kotler has said: 'Watch the product life cycle; but more important, watch the market life cycle.' What do you think he means by that?

Extension strategies

Firms may try to prevent sales going into decline by using extension strategies. There are various techniques they can use:

1. Find new uses for the product: Mouthwash Listerine was originally marketed as a floor cleaner. When repositioned as a mouthwash sales jumped from $115,000 to $7 million a year.
2. Change the appearance, format or packaging: Coke cans, bottles, etc.
3. Encourage use of the product on more occasions: for example, cereals not just for breakfast, ice cream in the winter.
4. Adapt the product: make it 'new and improved'.

Drawing the right conclusions

If a business has the right product, loved by loyal customers, marketing becomes an easy and cost-effective task. People who love MAC make-up don't need much prompting to go and buy more. And, thanks to e-commerce, they don't even need a MAC shop in place nearby. Services can have the same loyalty, such as people who love their local football team, or holidaymakers who go back to the same hotel every year. This has led many to conclude that 'product' is the most important aspect of the marketing mix (the 4Ps).

Revision essentials

Aesthetics: how things appeal to the senses; do they look great, smell good, feel nice, sound solid (the 'ker-lunk' of a BMW door shutting) and taste great?

Design mix: finding the right design balance between function, aesthetics and cost of manufacture.

Economic manufacture: making the product cheaply enough to make it profitable.

Extension strategy: an attempt to prolong sales of a product for the medium to long term, to prevent it from entering its decline stage.

Function: how well the product or service works for the customer; for example, are the beds comfortable at a hotel; does the smartphone take sharp photos?

Product differentiation: the extent to which consumers see your product as being distinct from its rivals.

Product life cycle: the theory that every product goes through the same four stages of introduction, growth, maturity and decline.

End of chapter exercises

1 Describe what happens during the introduction stage of a product's life.

2 Outline what could happen to profits for a product that is at its maturity stage.

3 Explain one possible reason why some products have much longer life cycles than others. Use examples to illustrate your answer.

4 Look at the examples below and match up **each** statement to the **correct** life cycle shown in Figure 36.2.

(a) A product that is very popular but which, after a time, loses its popularity.

(b) A new product that flops.

(c) A product that becomes popular very quickly and continues to have good sales.

(d) A product for which sales vary, season by season.

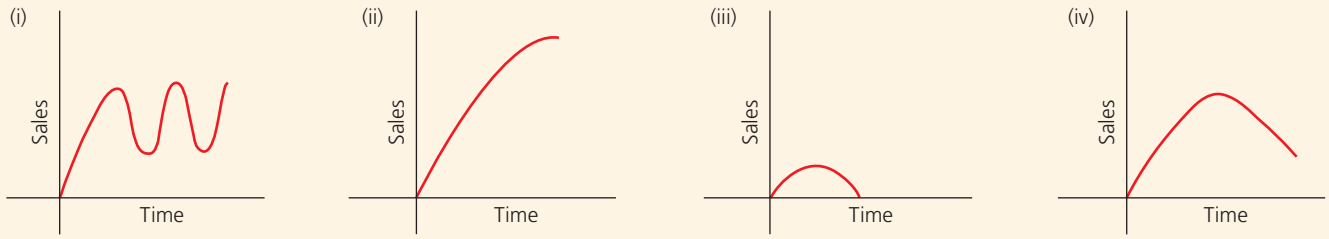


Figure 36.2 Sales/time graphs

Practice questions

Ooni: making pizzas make money

After finishing work on a Friday Kristian Tapaninaho used to enjoy making pizzas for the family, but was frustrated that no oven was hot enough. At the time the cheapest pizza oven (850° centigrade) was £2,000, so this was not an option.

He looked into designing and making pizza ovens for family, rather than business, use. People were prepared to spend £250 on a barbecue, so why not a pizza oven for the garden? Kristian had spotted a market gap with huge potential; pizza is a global phenomenon.

Kristian spent two years working on prototypes. The design goals were simple: generate the necessary 850°C temperature safely, be small and light enough to avoid excessive delivery charges, and make great pizzas, quickly. His Koda oven bakes a pizza in 90 seconds – perfect for making a crisp base and a chewy pizza crust.

Ooni was born, and its first pizza oven was priced at £199. The first sales were made in 2013; in that year sales were over £100,000 with a profit of £5,000. Since then the business has boomed, with sales in 2018 achieving £10 million (small businesses can be slow to publish their accounts; Ooni says it's had a great 2020 lockdown, but its latest published accounts only run up to 31 December 2018).

Figure 36.3 shows a fuller picture of the business' success. By the end of 2018 the business had more than £1 million in the bank – and that was before the 2020 lockdowns, which would have boosted online sales.

Today Ooni sells its pizza ovens in the USA and across Europe as well as in the UK. The ovens are made in China, so February 2020 saw a panic moment when the Covid-19 lockdown in China meant no supplies were coming through from Asia. Fortunately Ooni held enough stock to cope, and in any case the supplies from China recovered in time for the lockdowns across Europe. It is clear that Ooni sales rose sharply during lockdown, leading some experts to suggest that the company's 2020 sales may be around £20 million. Ooni says it's the world's biggest supplier of portable and outdoor pizza ovens. Its future looks very tasty.

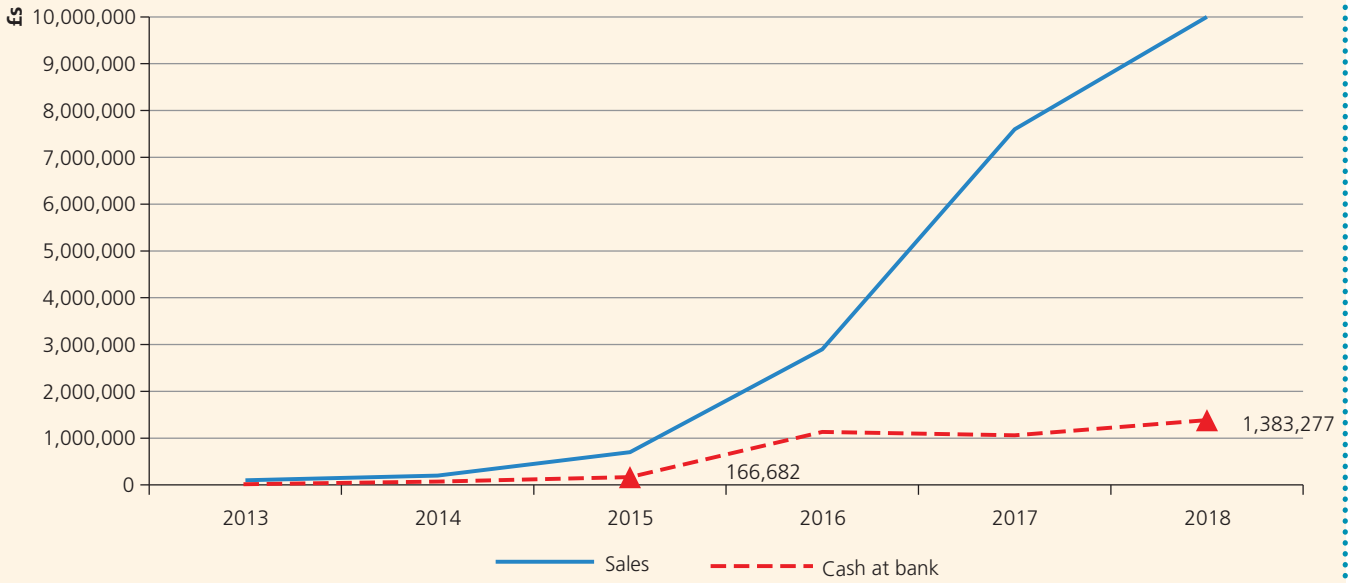


Figure 36.3 Ooni sales and cash generation (Source: Ooni accounts, Companies House)

Total: 19 marks

1 Outline one factor that may have influenced Kristian's pricing strategy for his first pizza oven. (2)

2 Using Figure 36.3, calculate, to 2 decimal places, the percentage increase in Ooni's cash holdings between 2015 and 2018. You are advised to show your workings. (2)

3 Analyse how well Kristian used the design mix in developing outdoor pizza ovens. (6)

4 Although Ooni ovens are sold in Europe, until now Kristian has avoided Italy – the home of pizza. 2021 is the year to launch in Italy and Kristian is considering two options:

- Option 1: Establish a network of 200 shops across Italy to sell the ovens.
- Option 2: Rely on 'e-tailing', i.e. sell only through an e-commerce website.

Justify which **one** of these two options Kristian should adopt. (9)

37 Price

The key to success is to ensure that the price is 'right'. In some cases this may be very expensive. A Lexus RX 350 costs £52,500; it will never outsell the Ford Focus, but Lexus customers wouldn't want everyone to have one! At £52,500, though, Lexus customers are still able to convince themselves that they are getting value for money.

Broadly, there are two different types of pricing:

- pricing low for high volume but low **profit margins**
- pricing high for low volume but high profit margins.

In its luxury segment of the market, Lexus has a strong enough brand name and product that it can price high. Weaker brands have to price low, such as the *Daily Express* newspaper, which sets its price below that of its stronger rival, the *Daily Mail*. At the time of writing the *Daily Mail* is 80p; the *Daily Express* is 75p.

Strong brands can set their own prices; weaker ones have to follow the lead set by others.

Table 37.1 Prices set for strong and weak brands

Strong brands set their own prices	Weaker brands follow the lead set by others
Manchester United season tickets	Kingsmill bread
Heinz Ketchup	Double Decker chocolate bar
Wrigley's Extra gum	Kia motor cars

In Figure 37.1, all five products contain exactly the same dose of ibuprofen (a painkiller often used to treat headaches). Although they contain the same active ingredient, one is a TV-advertised brand (Nurofen). Yet the branded item expects to be able to get away with charging more than ten times the price per dose charged by Asda.

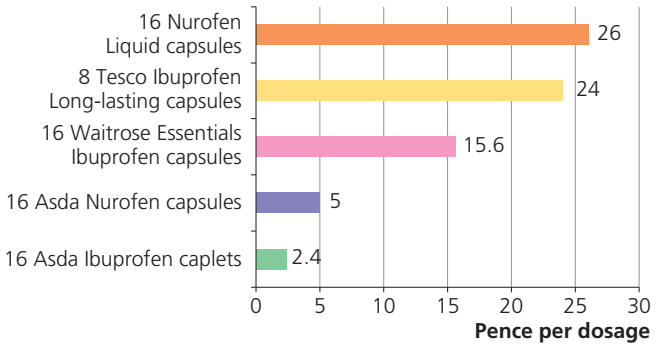


Figure 37.1 Pricing differences on ibuprofen (painkiller), August 2021

Talking point

What might explain why Tesco can sell ibuprofen at ten times the price charged by Asda?

Pricing strategy for different market segments

Mass market

In the mass market price is likely to be kept low in order to fight off the competition. That will lead to high sales volumes but at low profit margins. If you make just £1 of profit per sale but sell 500 items per day, you will make £500 profit a day. Not bad. The problem comes if further competition pushes price and sales volumes down even more. A 50p profit on 400 items means just £200 of profit.

Businesses such as Primark, Lidl and Aldi have shown that a successful, profitable business is

possible at low prices in the mass market. But it is important to remember the nature of the mass market that these four retailers operate in. A fully mass market needs:

- little effect from seasonality: if sales are high at Christmas but thin for the rest of the year, it is not really a mass market – therefore low pricing is unlikely to generate enough revenue to cover the costs
- little effect from regionality: if sales are high in one region but weak elsewhere, low pricing is unlikely to cover the fixed costs
- high levels of consumption: while few households would buy more than one fridge every five years, they might be buying ten packs of yoghurts every week; when households buy lots of one item, price becomes far more important.

> Price is what you pay. Value is what you get.
>
> *Warren Buffett, US business magnate and investor*

Niche market

A niche market is based on a particular type of customer who needs or wants something different from the majority. Sports cars are a niche market, so too are electric cars. In January to June 2021, Jaguar sold 9,000 cars in the US while Ford sold 1,150,000. So, Jaguar's sales were 0.8 per cent of Ford's sales. It is understandable, then, that Jaguar needed to charge significantly higher prices in the USA than Ford. Jaguar was working on the basis of high price–low sales volume, but high profit margin. That's a good way to ensure that profit is made even though sales volumes may be quite small.

How technology influences pricing strategies

The big change to pricing decisions in recent years has been due to the increased use of information researched on the internet, as well as the increase in e-commerce. Table 37.2 gives an example of the value of 'Googled' information. A 15-minute search for 'Vauxhall Corsa 1.5 SRI D 5-door' revealed the following:

Table 37.2 How technology has affected pricing

	High street 'dealer'	Three online retailers of new cars		
	Robins & Day, Kingston	UK Car Discount	Nationwide Cars	Cars2buy
List price	£20,685	£20,685	£20,685	£20,685
Quoted price	£20,440	£17,374	£16,824	£16,399
Saving	£245	£3,311	£3,861	£4,286

As a high street dealer, Robins & Day know perfectly well that no one will come to them via this sales channel. Businesses like this must try extra hard to gain favour from existing customers to keep them coming back.

Another way to look at pricing is in relation to e-commerce. In the past a specialist record shop may have had little prospect of selling vinyl album *The Dock of the Bay* by Otis Reading. It would probably put it in a bargain basket at perhaps £3. A modern e-commerce business could price it higher because it is easy for people round the world to access the website. So, potential demand is higher, which allows the supplier to charge a more realistic price, perhaps £20. Needless to say, the difference between a price of £3 and £20 is hugely significant in terms of profitability.

Pricing strategies at different stages of the product life cycle

Introduction

Many businesses change their pricing approaches as a product goes through its life cycle. Restaurants usually start off with moderately priced menus,

enabling reviewers to say 'good value for money' and for staff to enjoy a buzzy atmosphere and busy services (more tips). If the place gets busy, menu prices will steadily move upwards. By starting with a low price–high volume approach, the restaurant gains a large number of regular customers who may be willing to accept future price rises.

But not all restaurants use the same pricing method at their introductory stage. Just after the Russian-owned Novikov restaurant opened in London, *The Guardian* reviewed it by saying: 'It's massive, expensive and the food is shocking. But what's truly surprising about Novikov is that it's always full.' Here, the owners' pricing policy was different to most. They wanted Novikov to be the place of choice for celebrities and rich Russians. The high prices guaranteed that only the wealthy would go there, which was exactly what those customers wanted.

Talking point

If a new pizza delivery place opened locally, what problems might it face later if its opening launch price was £2.99?

Growth

In the early stages of growth many companies are thrilled to see revenues and profits rising – and they keep prices relatively low. Once the growth is more established, price rises are irresistible. If prices can rise, the business can finance growth without having to worry about finding an external source of capital. Once growth is established most businesses charge higher prices, even if this tends to hold down sales volumes.

Maturity

When growth is at an end, new pricing decisions may be needed. For the growth period the business may have thought, 'let's keep prices down in order to keep this growth going'. If managers accept that growth is over, they may want to squeeze prices up – even though sales may decline slightly. Managers may want to get more profit from the brand before decline sets in – especially if they've decided that new investment is needed to develop a new product.

Decline

When sales have made a decisive step downwards, further thoughts are needed on pricing. For many years Fry's Turkish Delight suffered falling sales. Brand owner Cadbury reasoned that sales were falling because few new customers were coming to the brand. Old ones were staying loyal but there were too few new customers to keep sales up. So, thought managers, let's push the price up and enjoy good profits: they did. Nowadays, though, the brand has become too minor to keep its own pricing; Tesco, for example, just bundles it in with a general 'buy any three chocolate bars for £1.20' offer.

> The sole purpose of marketing is to sell more to more people, more often and at higher prices. There is no other reason to do it.
>
> *Sergio Zyman, former marketing executive at Coca-Cola*

Drawing the right conclusions

Pricing is an area of business that is more art than science. In other words, pricing is usually a matter of judgement. MAC lipsticks sell for £17.50 while Superdrug ones are £1 and Rimmel is £5.99. The price of the MAC one perhaps does two jobs: it places the MAC product far out of reach of the majority, and confirms in the consumer's mind that the MAC one is stylish/high quality.

Revision essentials

Profit margins: profit as a percentage of the selling price (for one unit) or as a percentage of total sales revenue (for the business as a whole).

End of chapter exercises

1 Explain the importance to a business such as the *Daily Mail* of charging 5p more per paper than the *Daily Express*.

2 Explain one possible reason why Apple might change the price of its latest iPhone when sales move from growth to maturity.

3 **(a)** Using the information in Table 37.2 on page 200, calculate the saving a Robins & Day customer can make by going to Cars2Buy. Express your answer as a percentage of the Robins & Day price.

(b) Explain one possible reason why the online car dealers were able to offer lower prices for the Vauxhall Corsa than the high street dealer.

Practice questions

How SHEIN cracked the online fashion market

SHEIN, an online fashion store founded in China, is a phenomenon in the UK, rocketing from 500,000 to 4 million unique monthly visitors in just six months. Now the third most visited fashion e-commerce site in the UK, behind only Next and ASOS, it has also established a presence in 230 global markets. The secret: on-trend looks and amazingly low prices (at the cost, some reviews say, of very poor quality).

The company targets the sizeable under-25s market, who don't respond to the same pull and push factors as their parents' or older siblings' generations. SHEIN has been smart in targeting this group and we can draw two main lessons from its success:

1 Devote yourself to what matters. SHEIN champions trend-led clothing at unbeatable price points. The company does everything in-house, with its own team of designers and products made in China but distributed globally. The fact that it has grown so quickly has allowed it to rapidly increase production volumes and benefit from bulk-buying discounts. This has allowed it to undercut competitors such as ASOS, H&M and Zara. What SHEIN is not is fast or seamless, with delivery taking up to two or three weeks. For their core customer, though, this doesn't matter – the cost savings are worth it.
Primary research at OC&C shows that 55 per cent of under-25s quote price as the most important factor when shopping for fashion, and they're willing to trade off speed and ease to meet this need.

2 Get social media right. Brand awareness is built online to great effect, with traffic starting from Instagram and YouTube. This makes sense. Under-25s enjoy discovering fashion brands via real-life friendship networks, social networks and targeted mobile ads. SHEIN has mastered the art of putting itself at the forefront of young people's social worlds. Search 'SHEIN haul' on YouTube to see influencers talking through just how many on-trend clothes they have managed to buy from the store. Many of these videos have been viewed hundreds of thousands of times and some have reached upwards of 3 million views.

Source: Adapted from OC&C Strategy Consultants, 13 August 2019

Total: 20 marks

1 Outline one reason why SHEIN might benefit from using a retail distribution channel as well as an e-tail one. (2)

2 Explain how primary research can help a business to produce successful product designs. (3)

3 Analyse the probable influences on SHEIN's pricing strategy for the UK. (6)

4 To build a long-term competitive advantage in the UK, SHEIN has identified two options:

- Option 1: Spend more heavily on fashion influencers.
- Option 2: Hold stocks in the UK to achieve faster deliveries to customers.

Justify which **one** of these options SHEIN should choose. (9)

Practice questions

Sony goes for Spiderman

In February 2020, Sony confirmed that it had bought games developer Insomniac for $229 million. Insomniac is best known for its 13m-selling *Spiderman* game – an exclusive to Sony's PS4. Founded in 1994, Insomniac has largely developed games for Sony platforms. Finally, Sony had decided to buy its supplier.

There are several possible reasons for why it decided to do so at this time. Although the PS4 is now outselling Microsoft's Xbox One by three to one globally (more than six to one in Europe), both these consoles are being beaten badly by the Nintendo Switch. In the week to 8 February 2020, global sales of the Switch were twice as high as the PS4. As you can see in Figure 37.2, the dominance is especially strong in Japan – a market that has always favoured consoles that can be used on the move.

Fortunately for Sony, its new PS5 is scheduled to launch before Christmas 2020. Rumours suggest the manufacturing cost will be £360 per console, perhaps forcing a launch price far above the £349 that the PS4 launched at in 2013. Remember, though, the big profits are made on selling the games – the software.

Source: Topical cases, A–Z Business Training, March 2020

Total: 27 marks

1 Using the information in Figure 37.2, calculate, to 1 decimal place, the percentage of Nintendo Switch sales that occurred in Japan. (2)

2 **(a)** Using the information in Figure 37.2, calculate, to 1 decimal place, Xbox One's market share in Europe. (2)

(b) Analyse the possible effect on Xbox One of this level of European market share. (6)

3 If the average price for a Nintendo Switch console is £200, calculate the total revenue generated by its global sales in the week of 8 February 2020. (2)

4 Analyse the possible impact on Sony of taking over Insomniac. (6)

5 Sony planned to launch its PS5 before Christmas 2020. It had to decide on the launch price. It had two options:

- Option 1: Price match the Nintendo Switch, at £269.99.
- Option 2: Have a higher price strategy at £369.99, including a brand new *Spiderman* game, only available on the PS5.

Justify which **one** of these two options Sony should choose. (9)

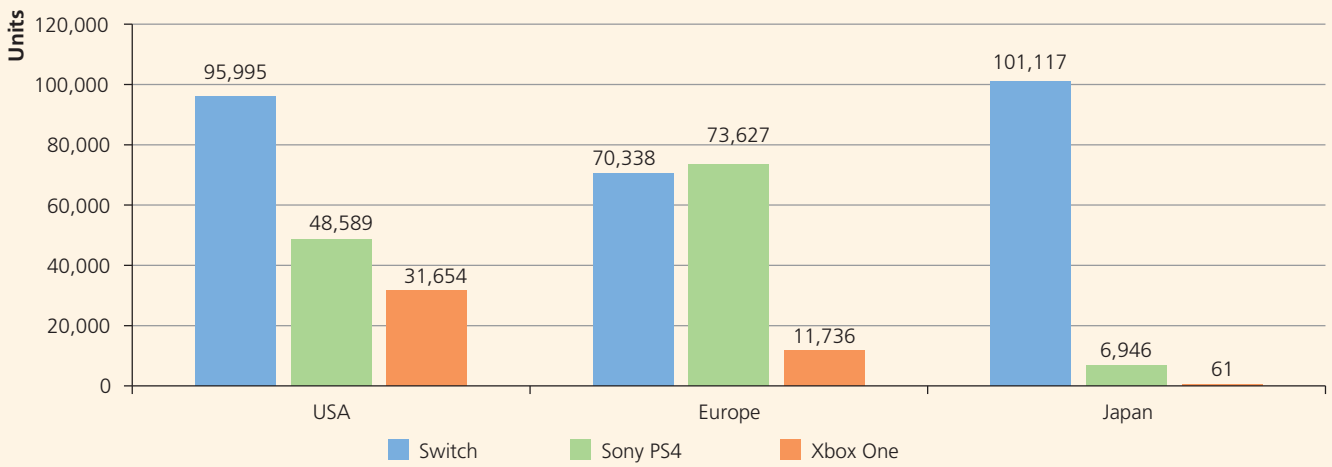


Figure 37.2 Top console sales: three biggest markets (Source: VG Chartz, data for week of 8 February 2020)

38 Promotion

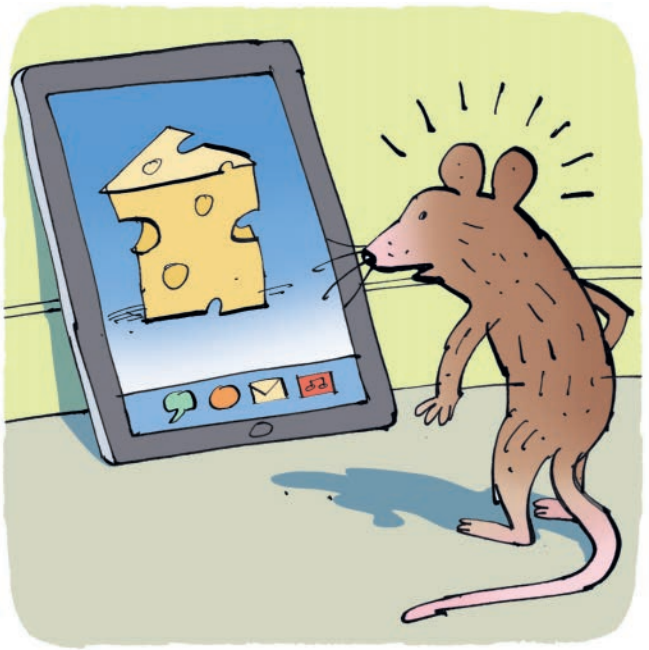
A strategy is a medium- to long-term plan for meeting your objectives. Objectives are what you want to achieve; strategy is how to achieve it. **Promotional strategy**, therefore, is the plan for how to communicate so effectively with customers that the business achieves its sales revenue target.

Promotional strategy for different market segments

Advertising

In the mass market the role of advertising is often to achieve name recognition, and little more. Home-delivery customers have heard of Just Eat, therefore they feel more comfortable using it than an unknown business that might run off with their credit card details. Of course, over time the business would love to develop the strong brand image of Chanel No. 5 or L'Oréal, for example, but that takes a huge, long-term investment in advertising. L'Oréal first used the slogan 'Because I'm worth it' in 1971 when the brand was one among many cosmetic companies. More than 50 years with the same slogan has helped L'Oréal become the world number one in cosmetics but at premium prices – the manufacturer's ideal.

Of course, in a smaller market segment the advertising approach might be quite different. G-Star RAW is a modern, international clothing business that remains focused on the under-25s. It has avoided television advertising, not only because it is hugely expensive but also to help with its street credibility. Its 'urban' image requires digital advertising, plus price promotions through coupons that are little known about. The customer must 'find' them.



Years ago people believed that all you needed to do was to 'build a better mousetrap'

> Sell the problem you solve, not the product.
>
> *Anon*

Sponsorship

Sponsorship means paying to have your brand or company name attached to an activity that has credibility with your customers. The activity is often focused on sport, but might also be based on music, art or other cultural events.

Sponsorship has been used brilliantly by Red Bull to help enhance the credibility of the brand. Sponsoring extreme sports and Formula 1 has given the brand global coverage as well as an edgy, 'risk-taker' image.

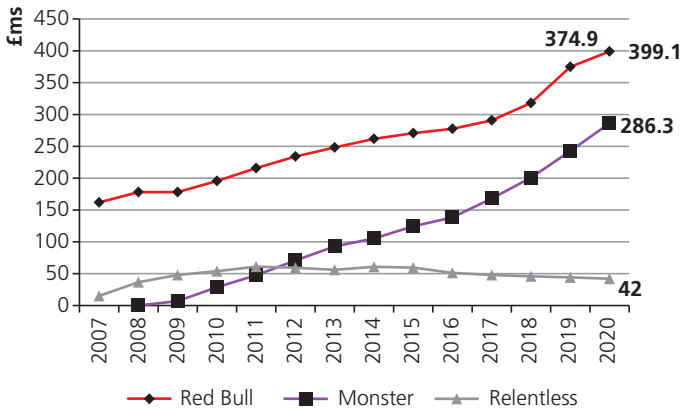


Figure 38.1 UK market for energy drinks, 2007–20 (Source: *The Grocer*)

Originally Red Bull needed a strong image simply to build the energy drink category in the UK and elsewhere. Since 2007, it has also needed to fight off two Coca-Cola-backed brands, Monster and Relentless. As can be seen in Figure 38.1, despite Monster's huge rise, Red Bull keeps growing.

But what is the cost of using sponsorship as a form of promotion? In 2019, Red Bull's spending on Formula 1 alone amounted to £237.3 million. With its many other sponsorships, it must be spending more than half a billion pounds a year. Its sales success in the UK and elsewhere in the world suggests that Red Bull knows what it's doing. The precise benefits of this spending are hard to identify.

Further examples of the high costs of sponsorship include the following:

- In 2020, phone business Three signed a £200 million, three-year deal to sponsor Chelsea Football Club's shirts.
- In 2019, Coca-Cola signed a $3 billion deal to sponsor the Olympics for the next 12 years, i.e. running up to 2031. The global reach of the Olympics is a perfect fit with global brand Coca-Cola.
- In 2013, golfer Rory McIlroy signed a £150 million sponsorship deal with Nike. Incredibly, in 2016, Nike announced it was withdrawing from making golf equipment, but still had seven years to go on its McIlroy contract. The sponsorship was quietly switched to sports clothing. Then in 2017, McIlroy signed a $100 million contract with TaylorMade for golf clubs.

> If you look at the sponsors who were in the sport 15 years ago compared to now, there are a lot fewer. Why? Because those runners who took drugs tainted the sport. They tainted all of us in it.
>
> *Maurice Greene, former 100 m world record holder*

Branding

When done well, nothing in marketing is quite as effective as **branding**. In the market for baked beans, truly 'Beanz Meanz Heinz' (an advertising slogan dreamed up in 1967, and still going strong more than 50 years later). The trick with branding is to give the brand an identity, even a personality. Richard Branson's Virgin brand is seen as being bold and independent; Innocent Drinks is seen as quirky, and Red Bull as edgy. Successful branding can mean that an image stays with people years, even decades, after the reality has changed. Innocent Drinks, after all, is now a small unit within Coca-Cola; and Virgin is a corporate empire owned by a guy soon to turn 75. So, successful branding can represent great value for money for a company. A special offer can boost sales for a short time but branding can boost sales for decades.

'Beanz Meanz Heinz' is still a successful slogan

Product trials

A product trial means giving potential customers a free taste – or longer trial – of your new product. This approach is used when there is known to be a hurdle that is likely to prevent customers from making a purchase of their own. For example, a new brand of luxury ice cream might be priced at £5.99, making it a lot to pay for something that you might not like. A free sample, handed out in a mini cone, might convince a customer that it is just what they want for a birthday treat.

It is important to remember that activities such as this are very expensive to run – not because of the free product but because of the labour time involved. Hiring people is always an expensive thing to do, so most companies could only afford to use product trials in a very targeted way. It might be best to use some form of social media to boost the impact of the trial, for example by recording and uploading videos to TikTok or Vimeo.

Special offers

Special offers should be regarded as the last resort. No company wants to 'give away' product, as with a 'buy one get one free' (BOGOF) offer. Can you imagine Apple running a BOGOF on the latest iPhone? It would undermine the image of the brand. For every business, the short-term benefits that can result from special offers should be set against the long-term damage to the brand. That said, there are times when special offers may work well:

- Your sales are always weak after Christmas, so you run a special offer in January and February: 'free: 40 per cent bigger pack'.
- A new competitor has just launched a product like yours, but cheaper; you run an on-pack competition with fabulous prizes to help lock your customers in.
- You are launching a new chocolate bar, so you bundle a 'free trial size' to every pack of your best-selling brand.

The use of technology in promotion

Targeted advertising online

In 2020, UK spending on digital advertising (£15.4 billion) far outstripped television advertising (£4.35 billion). The success of digital media is partly that the spend focuses on where people are, especially children and young adults. Advertisers also love the targeting that is possible with digital advertising.

Through the use of 'cookies' and other ways of capturing information about individuals, advertisers today know who supports Scunthorpe Football Club, who loves Drake, and who's a fan of M&Ms. All the data is then used to target those individuals, so June–July advertising of Scunthorpe season tickets goes only to those who are known fans; those living in Scunthorpe who support Leeds receive advertising for season tickets for Elland Road.

For advertisers of mass market brands, such as M&Ms and Coca-Cola, television advertising can still be cost effective. When promoting products that only appeal to a smaller segment of the population however, targeted advertising online can be much better value for money.

> Focus on how to be social, not how to do social.
>
> *Jay Baer, business author*

Viral advertising via social media

Costa achieved an extraordinary 44 million 'Impressions' on TikTok after creating 14 advertisements to fit lifestyle choices such as fitness, animals, singing and luxury. As the advertisements sneaked their way into people's TikTok viewing, Costa enjoyed a boom in customers asking for less well-known parts of its menu options. In many cases these would be higher-priced, higher profit-margin items. Of course, it is easy to see why great video advertisements can 'go viral', in other words

get passed on from person to person via Tweets and other social media. But every company asks for great advertising, and rarely gets it. **Viral advertising** via social media is a wonderful success when it is done well but all too often will fall flat. A Heinz 'viral advertisement' launched at the same time as the Costa one received 300,000 views in three years – a trivial number for such a big brand. Creative genius is always a wonderful thing – but not something to rely on.

> Marketing is no longer about the stuff you make, but about the stories you tell.
>
> *Seth Godin, entrepreneur*

Talking point

Google 'Dramatic surprise on a quiet square' and watch (more than 75 million people have already done so). Discuss what makes it such a successful viral video.

E-newsletters

If you buy a cinema ticket online, you are likely to end up receiving the cinema's weekly newsletter. It will tell you about major new films, and maybe offer discounted tickets for Monday or Tuesday evenings. From the company's point of view, the direct cost of sending out the newsletter is virtually zero. The costs involved are to do with setting up the IT system (perhaps no more than buying in a software platform) and then getting someone to write and design the content. Compared with the cost of advertising in the local paper (the traditional method), this is cheap.

Of course, many businesses want to do something more exciting or at least more interactive with their newsletters. This is perfectly possible but likely to cost a lot more. The wonderful thing about digital promotion is that the initial costs can be quite small, and it is possible to become more ambitious when you can afford it; a new, small business can perhaps spend £1,000, while an established but ambitious business can spend £15,000.

E-newsletters can be a cost effective way of spreading information

> It no longer makes economic sense to send an advertising message to the many in the hope of persuading the few.
>
> *Lawrence Light, former chief marketing officer at McDonald's*

Drawing the right conclusions

Promotion seems like the easiest part of the 4Ps. In fact, there are plenty of ways things can go wrong. In 2017, a Pepsi commercial featuring Kendal Jenner was taken off air after criticism that it was exploiting the Black Lives Matter movement to sell cola. The secret to promotional success is to take customers seriously – by listening every bit as much as talking. Then promotion gets a whole lot easier.

Revision essentials

Branding: giving your product or service a name that helps recall and recognition, and gives a sense of personality.

E-newsletters: regular updates on the activities of a business sent electronically to actual or potential customers.

Promotional strategy: a medium- to long-term plan for communicating with your target customers.

Sponsorship: when companies pay to have a brand associated with an iconic individual or event (usually connected with sports or the arts).

Viral advertising: when people start to spread your message for you through social means, be it word of mouth or via social media.

End of chapter exercises

1 Would clothing company G-Star RAW be better off promoting their product through online media or traditional media such as TV or cinema? Explain your thinking.

G-Star ***RAW*** outlet

2 Explain why promotions such as 'buy one get one free' may be a mistake for some brands.

3 Look at Figure 38.1 on page 205. Outline two possible reasons why sales growth of Red Bull jumped ahead in 2019.

4 Explain one reason why it makes more sense to use television advertising for big, mass-market brands than for brands that appeal to a small segment of the market.

5 Look at the bar chart in Figure 38.2, then answer the questions.

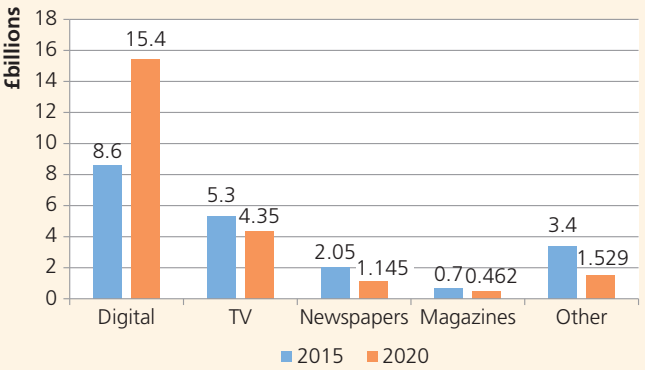


Figure 38.2 Money spent on advertising in the UK, 2015 and 2020

(a) In 2015, 42.9 per cent of all advertising spending was digital. Calculate the corresponding figure for 2020.

(b) Calculate the percentage change in advertising in newspapers between 2015 and 2020.

(c) Explain the possible effect of this change on people working for newspapers, such as journalists.

Practice questions

Little Moons

In winter 2021, there were three big viral hits: sea shanties, Handforth Parish Council's Zoom meeting and, of all things, Little Moons. In the first week of February, Tesco reported that its sales of Little Moons rose by 700 per cent. It beat its entire December 2020 sales in just four February days.

The reason: the ice cream brand had become a viral sensation on TikTok. *The Grocer* magazine reported 19.5 million views on the #LittleMoons hashtag, but by 6 February the hits reached 65 million. And there were an increasing number of reports that the product was out of stock in Tesco and Waitrose.

The business started in 2010 when brother and sister Howard and Vivien Wong decided that the UK needed Japanese 'mochi' ice cream balls: mochi soft pastry on the outside and a ball of soft ice cream in the centre. Typical flavours include coconut, and mango and passionfruit. It took them two years to perfect their recipes and more than four years before the business started to make profits. The breakthrough came in 2015 when they got their first distribution in a large supermarket chain: Waitrose. Growth continued with sales overseas, then a huge step forward came in 2020: they opened a new £3.5 million factory – and achieved a huge expansion in distribution at 500 Tesco stores. In 2020, Howard and Vivien's business made a profit of £650,000.

All this before the dramatic TikTok boost to their business in 2021. With a new factory capable of handling rising sales, this very profitable business could easily be worth £50 million.

Total: 24 marks

1 Outline the impact of social media on Little Moons' business. (2)

2 Analyse which factors within the sales process may have been the most important in the 2015 breakthrough of selling Little Moons into Waitrose. (6)

3 **(a)** Using the information in Table 38.1, calculate the percentage change in Little Moons' cash at bank between 2015 and 2020. (2)

(b) Outline how the growth in the company's cash holdings would have helped it when sales boomed in 2021. (2)

4 The new £3.5 million factory has increased hugely the production potential for Little Moons. Evaluate the impact that cutting the retail price would have on sales. You should use the information provided as well as your knowledge of business. (12)

Table 38.1 Details from the accounts of V & H Ltd (Little Moons). All figures in £000s

Year	2013	2014	2015	2016	2017	2018	2019	2020
Fixed assets*	80	67	54	46	93	167	941	2,775
Cash at bank	25	44	482	966	1,269	1,936	1,124	1,516

*The value of the company's long-term assets including buildings, factories and machinery

39 Place

This element of the marketing mix is about how to get the product from the producer to the customer. There are three main **distribution** channels – traditional, modern and direct – but, today, the easiest way is to sell directly, via the internet. Many people love to go shopping, though, so retail sales remain important.

In addition to choosing the most appropriate channel, firms must decide on the type of store they wish to be distributed in. When it first launched, posh crisp maker Tyrrells decided it would rather not have its products on sale in Tesco. The directors believed the image of the brand would be built more successfully by being seen in small shops, plus the more upmarket **retailers** such as Waitrose and Booths. After ten years establishing its image, Tyrrells approached Tesco and a deal was done.

Methods of retail distribution

As shown in Figure 39.1, there are three main ways to get products from the producer to the consumer.

The first (the 'traditional' channel) means that producers sell in bulk to wholesalers, who sell in smaller quantities to small and independent retailers. So, a big truck goes from Mars to a wholesaler, such as Booker, full up with the full Mars product range. The one full delivery means that the delivery cost per item is small, allowing the wholesaler to sell quite cheaply to the local grocer.

Without wholesalers, small shops couldn't exist, as it would be too expensive for the producer to deliver to all the different outlets.

The second method is the most important by far in the grocery sector: the producer delivers huge quantities directly to a supermarket's distribution depot. Trucks deliver to the Waitrose depot in Bracknell from all over Europe; Waitrose trucks are then loaded up with the right supplies to be taken to individual stores. Then we do our shopping.

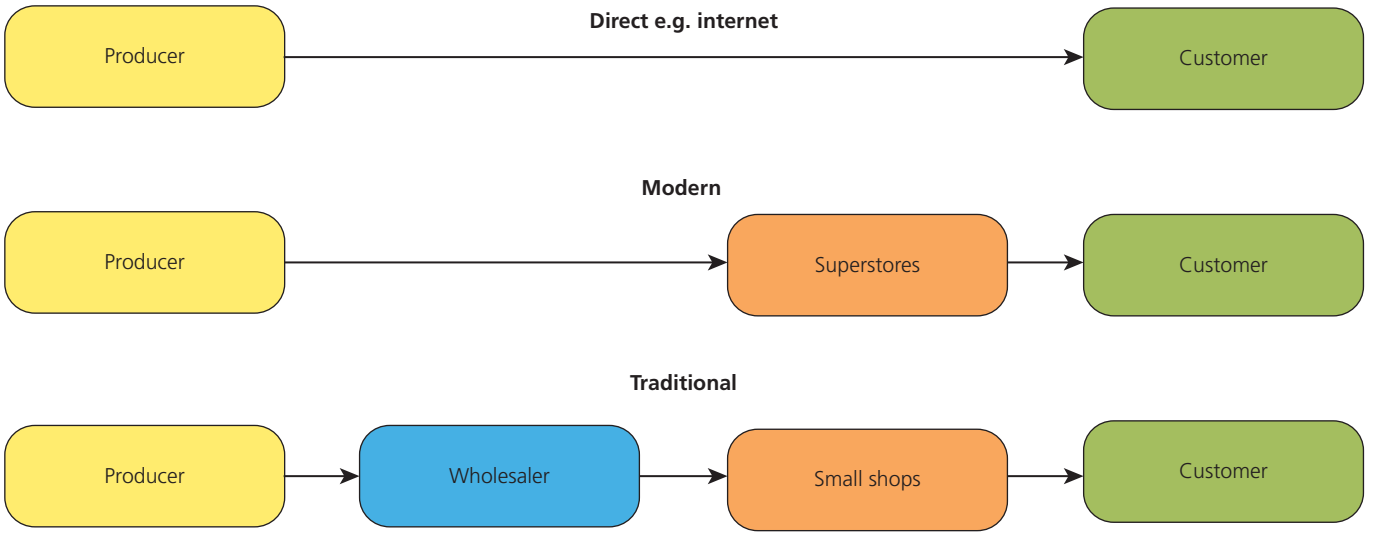


Figure 39.1 Distribution channels

Table 39.1 Physical retail distribution and the consumer

Advantages	Disadvantages
Customers can touch, hold, feel, smell and wear products before buying; makes it easy to compare with rival products	'Going shopping' is time consuming, especially when it seems important to make full comparisons (e.g. visiting lots of shops)
You can choose a lean piece of meat or a nearly-ripe piece of fruit; e-commerce can't match that	Choice can be overwhelming, leading to too much time being spent
You can take it away instantly; not even one-hour delivery can match that	You have to carry everything; especially hard for those without a car (30 per cent of households)

The third method is buying directly from the producer. This has always been possible from companies that offered a mail-order service (such as the original Next Directory). Today it is a booming segment of the market because of the convenience of shopping online, via e-commerce or m-commerce.

> A product with superior distribution will always win over a superior product with poor distribution or customer access. It's not fair. It's not right. But it's reality.
>
> *Stephen Davis, managing director*

Gaining retail distribution

First-time entrepreneurs are often surprised to find that getting retail distribution is hard – and keeping it still harder. Tesco would be delighted to stock own-label products plus some top brand names, but they are wary of small brands that may sell slowly and perhaps go out of date. To gain distribution a company needs to:

- show that its brand(s) offer something really different to the customer
- show the strength of marketing support to be put behind the brand
- provide an acceptably high level of profit to the retailer.

To keep in stock over a period of years the company will have to:

- provide regular promotional support to keep sales moving, such as half-price offers, financed entirely by the manufacturer
- make sure that sales flow through even when there's no special offer, for example by advertising that persuades new customers to try it out.

Talking point

Would you rather work in an e-commerce distribution depot or work face to face in a shop?

E-tail distribution or e-commerce

There are two main types of e-commerce:

- direct sales from producer to consumer, such as buying a MacBook computer direct online from Apple
- sales through an **e-tailer**: in other words, an electronic shop, such as ASOS.

Direct sales from producer to consumer are great for the producer, who receives the full retail price instead of having to make do with the wholesale price. E-tailers are more important today, however. Their shops display products online and have sufficiently slick, efficient systems to make it easy to purchase, deliver and even collect (when a disappointed customer wants to return the item). Because the e-tailer is saving the cost of running all those shops in local high streets, it can live with customers returning a higher percentage of their purchases than would ever happen in physical retailing.

Table 39.2 Online retail (e-tail) distribution and the consumer

Advantages	Disadvantages
The convenience of being able to order from home or when on the move is almost essential for carers looking after children or older people	Familiarity with a single app might make shoppers lazy – ordering online when going out might actually be better (older people need exercise)
You don't have to waste time driving, parking and shopping	Eventually, delivery charges will have to reflect costs
You can easily make price comparisons, allowing grocery shopping to be far better value	For staff, working on zero-hours contracts at the minimum wage in a giant warehouse can be far more soul destroying than working in a shop

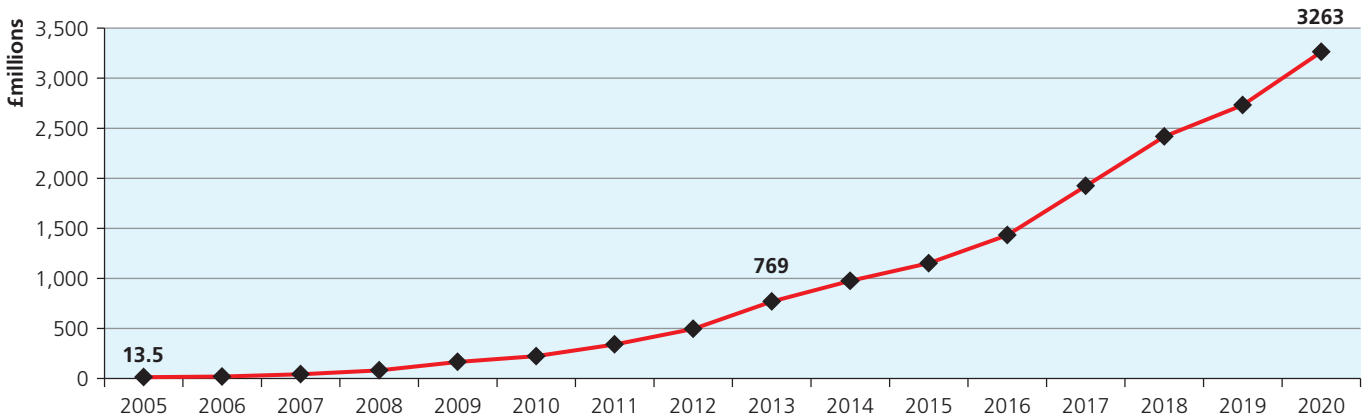


Figure 39.2 ASOS sales: e-tail sales growth, 2005–20 (Source: ASOS accounts)

The graph of ASOS' sales growth in Figure 39.2 shows the huge attractions of starting – or investing in – an online retail start-up. The company's growth has been staggering.

Drawing the right conclusions

Will online retailing inevitably keep growing at the expense of high street shops and shopping? Certainly it has a lot of momentum behind it, which probably means that more shop closures are to come. In early 2021, the British Retail Consortium (of employers) predicted that between 142,000 and 213,000 retail jobs would disappear by 2024. That's about six per cent of the total. But it may be that new, independent shops will open up in place of chain stores. As baseball coach Yogi Berra once said: 'It's tough to make predictions – especially about the future.'

Revision essentials

Distribution: how ownership changes as a product goes from producer to consumer.

E-tailer: an electronic retailer; in other words purchasing electronically, either by e-commerce or, more likely these days, mobile commerce (m-commerce).

Retailer: a shop or chain of shops, usually selling from a building in a high street or shopping centre.

End of chapter exercises

1 Which type of product are you most likely to buy online? Explain why.

2 Which type of product or service are you most likely to buy offline, in other words, from a shop?

3 Look at Figure 39.2 on page 212 and answer the following:

(a) Calculate the percentage sales increase between 2005 and 2013.

(b) Calculate the percentage sales increase between 2013 and 2020.

(c) Outline why sales may have followed this growth path.

4 Read the following extract and answer questions (a) and (b).

Aldi and Lidl have lost share of the grocery market for the first time in more than a decade, while Tesco's share rose for the first time since 2016, amid a surge in online shopping during the pandemic. Online grocery sales accounted for a record 15.4 per cent share of the market in the four weeks to 21 February 2021, up from 8.7 per cent last year. There remains a huge question, though, over the profitability of online grocery delivery. Sainsbury's has highlighted this in the past.

The switch to home deliveries led to a change in fortune for Lidl, which does not sell online, for the first time since 2010. Its fellow German discounter Aldi last year began offering online orders for picking up in store, or for home delivery via Deliveroo, in a limited number of outlets.

Retail analyst Fraser McKevitt said the discounters' sales `are up and up strongly, but sales are up more everywhere else. They have lost an opportunity but there is a question of what will happen once the pandemic ends.'

(a) Outline two possible reasons why customers may increase their grocery e-tail purchases even more in future.

(b) Discuss the possible effects on Lidl of a continuing trend towards buying groceries online.

Practice questions

UK retailers count the cost of returns

A record £1 billion of items were returned after last year's Black Friday as online customers adopted a 'buy now and decide later' attitude. Some stores – mainly women's fashion outlets – saw more than 60 per cent of online sales returned within 30 days. Business consultants Clear Returns suggests that returned parcels may be costing UK retailers £60 billion a year.

Many store chains have invested heavily in online distribution channels – only to find that stock management is made doubly difficult and expensive due to customer returns. George Mensah, a retail expert at consumer analyst Shore Capital, says the volume of online returns was a major concern for some retailers. 'Last year the disruption caused by having to deal with a high level of returned items in late December meant retailers struggled around Christmas time, and this year it could be even worse.'

'It can cost double the amount for a product to be returned into the supply chain as it does to deliver it,' says Iain Prince, supply chain director at KPMG. He points to the online purchase of a coat, for instance: 'To pick and deliver an order costs between £3 and £10 — it could cost double or treble that to be processed on the way back.' The risk is that 'All your [profit] margin is consumed in the process of handling and repackaging,' as a Clear Returns executive suggests.

According to some experts, around 20 per cent of fashion purchases on the web are for multiple items of a similar size, shape or colour. Customers deliberately over-order – intending to send back some items given that returns are free or cheap. Of course, from a customer point of view it makes sense. In a shop, you try things on and decide what fits and what looks good. When buying online it seems fair to pick and choose – forgetting the cost to the retailers.

Despite the problems, retailers cannot walk away from online. In January 2021, 37 per cent of UK retail sales were online (compared with 20.2 per cent in pre-Covid-19 January 2020). 'We want our customers to be happy and if they want to return items, we want to make that process as simple as possible,' says John Lewis. 'As such we will continue to focus on customer convenience.' Table 39.3 shows how costly that might prove.

Table 39.3 Online returns

UK retailers	Proportion of purchases returned (%)
Electrical goods	10
Homeware	10
Furniture	15
Health & beauty	15
Sports & travel goods	15
Fashion clothing	25

Total: 18 marks

1 **(a)** From Figure 39.3, identify which product category has the highest rate of customer returns. (1)

(b) Outline one possible problem for retailers about encouraging customers to buy online. (2)

2 Analyse whether customer returns are mainly an online, e-retailing problem. (6)

3 Companies such as John Lewis worry about the increasing cost of customer returns. They see two main options:

- Option 1: Charge customers the actual cost of delivery, as would happen if items were posted.
- Option 2: Continue with free delivery, forcing shop customers to subsidise online ones.

Justify which **one** of these two options a business such as John Lewis should choose. (9)

40 Marketing mix and business decisions

Business decisions are always about the future. So, when the marketing mix is being used to inform and carry out business decisions, it is also about the future. Because no one can know what the future holds, however, it involves uncertainty: a decision that seems right today may prove wrong tomorrow – through no one's fault.

Today I decide to switch my declining brand's image away from luxury towards being more of an everyday consumer choice. Tomorrow a luxury rival pushes its price up sharply. This would have boosted sales and profits for my brand, but I've effectively switched the brand out of that position in the market. My brand gains nothing when it could have gained a great deal. Bad timing. Unlucky.

Table 40.1 shows some real examples of good and bad marketing decisions.

Talking point

Which bad marketing decisions can you think of in recent times? Explain why you think they were bad.

How each element of the marketing mix can influence other elements

The key to the marketing mix is that it should all fit together in a way that works for the target market. Health-focused parents may want toddler snacks that have no added sugar and fit in the pocket. Success comes from a complete, credible marketing package:

- Product: 20 g packs of BEAR's Yoyo 'fruit nibbles', made from whole fresh fruit, giving one of your five-a-day 'with no added nonsense'.

Table 40.1 Examples of good and bad marketing decisions

Good marketing decisions	Bad marketing decisions
In 2012, recent start-up BEAR launched an advertising campaign to increase awareness of its Pure Fruit Yoyo rolls (for children). In the year that followed, sales rose by 72 per cent and kept rising to £22.5 million by 2015. By 2021, Yoyo had a 34 per cent market share in childrens' fruit snacks and launched a series of frozen foods, including BEAR Fruit Lollies.	In 2020, Nestlé, the giant company behind Felix cat food, wanted a social media campaign linking the 'mischievous cat' image to the lockdown boredom of cat owners. The online campaign went viral, yet by the year end, sales were down by £2.2 million, even though the overall market was up. Perhaps it was too serious a year for cat mischief.
In August 2021, Weetabix created a billion-view Twitter sensation with a tweet showing the cereal bars covered in baked beans. Restaurant critic Grace Dent called it 'the worst food I have ever seen', but newspaper headlines and the viral storm pushed Weetabix sales up by 15 per cent. For a £150 million brand such as Weetabix, that would be £22.5 million over a full year.	Loot launched in 2014 as an online bank targeting students. It offered clients a pre-paid Mastercard and student discounts. It secured £13.6 million of funding, £2 million of which was spent on marketing. But by 2019 it was running out of cash and went into administration in May 2019. RBS (NatWest) was a major investor; an expensive mistake.

Yoyo started in Waitrose and Ocado and branched out into other supermarkets

- Promotion: a cute, quirky, slightly amateur website (www.bearnibbles.co.uk) to make the customer feel that the products are made by nice people, not by a company.
- Place: originally launched into Waitrose and Ocado (good for middle-class credibility) but now in Tesco, Sainsbury's and Caffè Nero.
- Price: 49p for a 20 g pack. That's £24.50 a kilo – an extraordinarily high price for stewed fruit – but it hasn't caused any problems. It is reassuringly expensive for a baby treat but, of course, at just 49p a time it is easily affordable.

In the case of Yoyo, a price that's too low may damage credibility. So too might the news that the business is no longer owned by founder Hayley Gait-Golding but by Belgian biscuit-maker Lotus Bakeries. But there's definitely no sign of that news on the BEAR's website.

> We won't be different for different's sake. Different is easy ... make it pink, make it fluffy! Better is harder.
>
> *Jonathan Ive, chief design officer at Apple*

How the marketing mix informs business decisions

A successful business understands its customers, and therefore knows what products or services they want and how best to communicate with them. A critical business decision can come after a successful launch phase, when the business needs to expand. Customer demand is higher than the factory can cope with, so a new factory is needed. But how big?

Entrepreneurs use their understanding of the four marketing mix factors (the 4Ps) to get a sense of just how big demand might become. After all, the business may have spent little so far on advertising, in which case sales could be pushed up significantly simply by telling more potential customers about the product. In these circumstances it looks safe to build a factory much larger than the first one. If sales aren't strong enough to use up all the production potential, a strong advertising campaign should solve the problem. So the entrepreneur's understanding of the marketing mix has provided key information for making the right business decision.

Other ways in which the marketing mix could **inform** a business decision:

- Having a firm understanding of the impact of price changes on sales could help in deciding whether to increase prices in future. A six per cent price rise will increase revenue and profits if the number sold falls by only four per cent.
- Market research evidence that a brand image is strong – and backed by a consistent marketing mix – might encourage a business to launch a new product based on the same brand name.
- If a company knows it is losing distribution in supermarkets but gaining in small convenience stores, it may be sensible to develop and launch smaller pack sizes, such as a box of four eggs.

> Marketing is a contest for people's attention.
>
> *Seth Godin, author and entrepreneur*

How the marketing mix can be used to implement business decisions

Once a decision has been made, it is time to put it into practice. That's where decisions on the marketing mix come into play. For example:

- A head teacher decides to go ahead with an expansion plan: as the extra classrooms are being built, a marketing plan is needed to recruit 50 extra pupils for next September. The marketing mix comes into play (except for 'price', unless it is a private school).
- The boss of Tyrrells crisps decides to launch the brand in the USA, aiming for $20 million of sales within two years; the marketing manager must find the right marketing mix to achieve this objective.

What is needed is a three-part process:

1. Identify the decision objectives (50 extra pupils, or $20 million sales).
2. Agree how the 4Ps are to be used to achieve those objectives. Often this will require more money; in other words, the business may have to provide a bigger **budget** for marketing. If you're launching a brand in the USA, extra spending will be needed, for example on advertising.
3. Carry out the plan; in other words, make the required changes to the product, price, promotion and place.

Once the plan is in action, well-run companies analyse their sales figures to check whether it is working well. Sometimes adjustments are needed. For example Tyrrells launching in the USA may find it tougher than expected to get good retail distribution. US supermarket chains may keep saying no. They may need to switch away from supermarkets to target small shops, or perhaps focus distribution on bars and cafes instead of the grocery sector.

Drawing the right conclusions

Good business decisions can take several years to show their merits. That's fine as long as the business has long-term objectives. If Primark's boss decided to make the business a big player in the clothing market in China, it might be four or five years before it was clear whether it was the right thing to do. But whether the decision making is long term or short term, it is only likely to come good if the business truly understands its customers. That's where marketing comes in – especially market research and the marketing mix.

Revision essentials

Budget: a ceiling on the amount of money that can be spent; a marketing budget of £1 million means the marketing manager can spend up to that figure, but no more.

'Inform' decisions: evidence that can be used to make a better decision; a company can gain a better understanding of its customers through the 4Ps, which helps in decision making.

End of chapter exercises

1. Explain briefly why all business decision making is rooted in uncertainty.
2. Take one of the two 'good' marketing decisions from Table 40.1 on page 215. Explain in your own words why the decision was a good one.
3. Take one of the two 'bad' marketing decisions from Table 40.1 on page 215. Explain in your own words what went wrong.
4. Use the 'three-part process' to imagine how **one** of the following plans might be put into action:
   - **(a)** Lidl decides to start up a chain of better value pizza delivery outlets across the UK.
   - **(b)** Primark decides to start up a chain of better value cinemas across the UK.

5 Read the following extract and answer questions (a) and (b).

Swizzels is the largest British-owned sugar confectionery manufacturer. In 2012 it launched Squashies as a development from its Drumsticks fruit chews. By 2021, Squashies were the best-selling brand in the UK's £1 'hanging-bag' category of sweets. Swizzels promotes the brand mainly by 'seasonal and event activations'. Veganuary, Valentine's, Christmas and the football 'Euros' – each has a special Squashie product line. Swizzels' success is proven by sales: with Drumsticks (including Squashies) up from £16.1 million in 2016 to £40.6 million in 2020. Yum.

(a) Explain which element of the marketing mix Swizzels has chosen to focus on with Squashies.

(b) Which was the most important decision made by Swizzels' managers? Explain your thinking.

Practice questions

Chocolate joy in India

The chocolate market in India is quite small in international terms, but one of the world's fastest-growing. Despite the heat of India, the market is worth more than £1 billion a year. The biggest name is Cadbury, which has a market share of over 55 per cent; Cadbury's Dairy Milk holds more than a 30 per cent share on its own.

India is a developing nation and, while there are many affluent people there, the average Indian is relatively poor, so chocolate makers produce small bars at remarkably low prices, typically around 7p. Perhaps that's why Cadbury, Nestlé and Ferrero have been trying to boost the luxury end of the market (currently 12 per cent of the market). Cadbury has focused on boxed assortments for gifts at birthdays or festivals such as Diwali. These can sell for around £2. Nestlé has introduced KitKat Senses for an everyday luxury at 10p, while Ferrero has launched Kinder Joy for a 12p children's treat.

Although the market is dominated by multinational companies, local milk and chocolate producer Amul has managed to stay neck-and-neck with Mars by producing international-looking brands at Indian prices. Amul focuses its promotional spending purely on packaging design. It doesn't see the need to advertise; its low prices ensure good shop distribution.

The big market share winner in recent years is Italy's Ferrero, which uses TV advertising to attract children to its Kinder range.

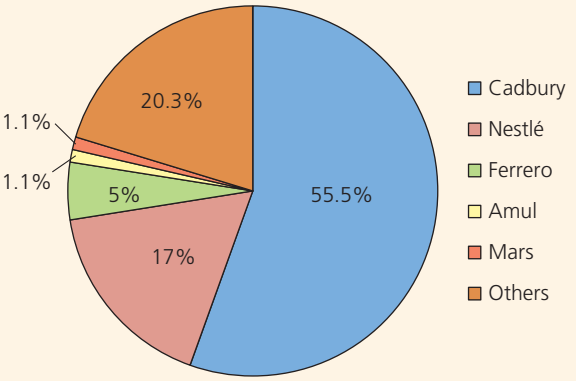


Figure 40.1 Chocolate market share in India

Total: 20 marks

1 Define the term 'multinational company'. (1)

2 **(a)** Using the information in Figure 40.1, calculate Cadbury's sales (in pounds) in India. (2)

(b) Outline one way in which Cadbury may have achieved such high sales. (2)

3 Analyse how Ferrero is using the marketing mix to boost its sales in India. (6)

4 Mars is considering two options for boosting its market share in India:

- Option 1: Focus solely on the market for adult chocolate gifts.
- Option 2: Attack Cadbury's Dairy Milk by launching Galaxy.

Justify which **one** of these two options Mars should choose. (9)

Exam-style questions on Topic 2.2

Don't rush; check your answers carefully.

1 Which **one** of the following best describes an 'extension strategy'? (1)

- **(a)** A boost to the sales of a product in its maturity phase.
- **(b)** A medium-term plan for extending a product's life cycle.
- **(c)** Developing a new product to replace the existing one.
- **(d)** A plan for getting a product back below its break-even point.

2 An extension strategy is best defined in which **one** of the following? (1)

- **(a)** A way to extend the brand by launching new variants.
- **(b)** A plan to lengthen a product's profitable life.
- **(c)** A plan to lengthen the time taken to pay suppliers.
- **(d)** A way to increase a product's durability.

3 Within the marketing mix, distribution is known as which **one** of the following? (1)

- **(a)** Position
- **(b)** Place
- **(c)** Packaging
- **(d)** Prominence

4 Which **one** of the following statements explains why Mars may be wrong to price the MaltEaster Bunny higher than Cadbury's Creme Egg. (1)

- **(a)** Creme Egg is the market leader with £50 million of sales in each of the past 20 years.
- **(b)** The MaltEaster Bunny has higher production costs than the Creme Egg.
- **(c)** The MaltEaster Bunny is highly differentiated.
- **(d)** Eating Creme Eggs is an annual ritual for many people in Britain.

5 Which **two** of the following are benefits to a business of having a strong brand name? (2)

- **(a)** Customers will be more willing to try new products with that branding.
- **(b)** The name ensures that sales are protected from competitors' actions.
- **(c)** A strong brand name makes it unnecessary to spend on advertising.
- **(d)** A good name makes it easy to cut product quality without losing sales.
- **(e)** Greater customer loyalty should make future sales a bit more certain.

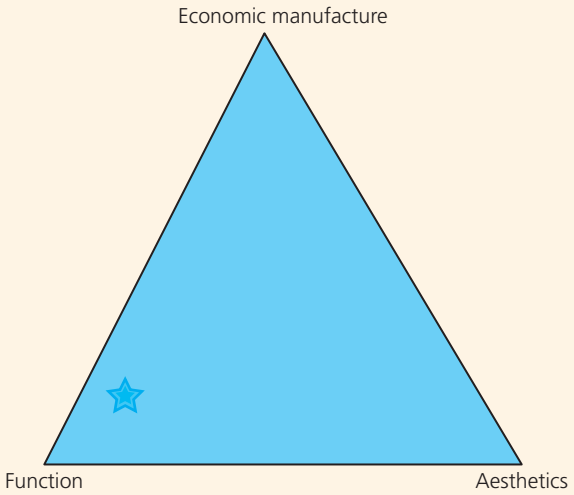
6 Which **one** of the following is an example of qualitative research? (1)

- **(a)** Group discussion
- **(b)** Sampling and selling
- **(c)** Questionnaires
- **(d)** Population statistics

7 Which **two** of the following items of information might Pepsi discover through quantitative research? (2)

- **(a)** The sales growth achieved by Pepsi Max.
- **(b)** The estimated sales for a proposed new product.
- **(c)** The reasons behind consumers' likes and dislikes of brands.
- **(d)** The cost of producing the number of goods people want to buy.
- **(e)** The percentage of the target market that want a blue pack instead of a red one.

Questions 8 and 9 are based on this pyramid diagram.



8 Which **one** of the following is the name given to this diagram? (1)

- **(a)** Market mapping
- **(b)** The design mix
- **(c)** The product life cycle
- **(d)** The marketing model

9 Which **one** of the following products might be represented by the star on the diagram? (1)

- **(a)** A new luxury perfume from Chanel.
- **(b)** A new smartphone to be sold only through Aldi stores.
- **(c)** A new robotic mini-excavator for construction sites.
- **(d)** A new ice cream flavour from Ben & Jerry's.

10 Many chocolate brands are over 80 years old (KitKat, Mars, Smarties). Which **one** of the following is a likely explanation of such long product life cycles in the chocolate business? (1)

- **(a)** Lack of new product launches by chocolate makers.
- **(b)** Customer loyalty to much-loved brands.
- **(c)** Successful cost-cutting by producers.
- **(d)** Effective use of social media to support recent new product launches.

Now try this discussion question.

11 Discuss whether a growing e-commerce business could benefit from opening its own shops. (6)

41 Business operations

In 2019, Nissan announced that it would cut 12,500 jobs worldwide, including 2,540 in India. The market was growing more slowly than expected, and Nissan's production costs needed to be low enough to compete with local giants Maruti-Suzuki and Tata Motors.

Even companies as massive as Nissan have to make sure that they keep costs low enough to be competitive. If Tata is offering a fuel-efficient family car in India for £5,000, Nissan has to make sure that its production costs are low enough to do the same. If it costs Nissan £6,000 to make each car, everything it sells will be at a loss.

The same is true for a local builder. If they have to charge £1,000 for building a wall but a rival can do it for £700, there is only one possible result: the more expensive builder must either give up or find a way to operate at a lower cost.

Every business has to be aware of its costs and how much its competitors charge

The purpose of business operations

'Operations' is the name given to the section of the business that provides the customer with the goods or services he or she has ordered. While the marketing department tries to get people to buy, **business operations** makes sure customers get what they want. When the product is produced in a factory, every part of the factory is part of 'operations', so too is the delivery process. Services such as window cleaning also require operations – that is, a process from website or app ordering through to appointments being made and kept, and perhaps a quality control system to make sure that customers are happy.

To sum up, business operations ensures that the right goods or services are supplied to customers at the right time and to the right quality standards.

> Manufacturing is more than just putting parts together. It's coming up with ideas, testing principles and perfecting the engineering, as well as final assembly.
>
> *James Dyson, British industrialist*

Production processes

There are three types of 'production' process – job, batch and flow – and they apply to the supply of services as well as goods.

Job production

Job production is one-off production for a one-off order. It is tailor-made to the specific requirements of a single customer, and therefore requires a high input of labour rather than machinery. For example, a tailor-made wedding dress requires careful measuring, fitting and refitting, plus hand-cut fabric. It might require 50 hours' work. That's no problem in a low-cost country such as Bangladesh where labour might be 25p an hour, but if the labour cost is £9 an hour, that's £450 just for the labour.

Examples of job production include:

- a loft conversion in an unusually-shaped 80-year-old house
- a tailor-made tennis dress for Emma Raducanu
- a babysitter for Mrs Jenkins between 7.30 and 11.15 p.m. on Friday night.

Table 41.1 on page 223 outlines the advantages and disadvantages of job production.

Batch production

Batch production means producing a limited number of the same item. It might be a huge batch of 10,000, or a small batch of four – either way it is batch production. With a small batch of four identical cakes, there are labour and energy-cost savings in mixing the ingredients, making the cakes and baking them all together. With a huge batch, a production line could be used for a day or two to produce 10,000 XL Manchester United shorts, followed by 8,000 XXLs. Batch production is often quite cost efficient because a degree of automation can be used, making it less dependent on labour time than job production.

Examples of batch production include:

- the production of 1 million packs of KitKat Witch's Brew for Halloween
- ten open-top, double-decker buses for the New York tourist authority
- a meals-on-wheels lunch service for 20 elderly people in West Leeds.

Table 41.1 on the next page outlines the advantages and disadvantages of batch production.

Flow production

Flow production is continuous output of identical products. The world's biggest baked bean factory is in Wigan; it produces 3 million tins of Heinz Beans a day, working 24/7 for the past 70 years. Flow production allows a factory such as this to be highly automated: the labour cost per tin of beans is below 0.1p – effectively nothing. For a product with a long product life cycle, such as Heinz Beans, flow production is a sensational way to achieve high profits while making something that seems good value to customers.

Examples of flow production include:

- Cadbury's Dairy Milk
- Cadbury's Creme Eggs – surprisingly, they are produced all year round even though they're only on sale between Christmas and Easter
- Nissan Jukes (in Sunderland) and BMW Minis (in Oxford).

Table 41.1 on page 223 outlines the advantages and disadvantages of flow production.

Can there be a mixture? Part-batch, part-flow?

Yes, and there often is. When a birthday cake is ordered from a baker, a batch of ten cakes may be baked; the job production element is just the iced decoration, whether it is 'Happy 6th birthday Rosie' or a couple of poodles for a dog-loving granny. Modern car manufacture is a mixture of flow, batch and job production. The flow of saloon cars may be interrupted for two days' production of a batch of estate cars, and each car is tailored to the customer's specifications – one is blue with a sunroof and alloy wheels, the next is red with black leather seats, and so on.

Table 41.1 Advantages and limitations of job, batch and flow production

	Advantages	Disadvantages/limitations
Job production	Highly flexible; gives the customer exactly what they want Satisfying work for the individual as it requires skills and flexibility	It will always be expensive in a developed (high-wage) economy The skills may be in short supply, making it hard for the business to grow
Batch production	Gain some cost advantages from producing several items at once ... yet still able to offer customers the colour/size they want	May be limited scope for automation, making production costs far higher than with flow production Not as flexible as job production
Flow production	Can automate production fully, making it highly cost effective (which should be good for customers as well as suppliers) Many customers value consistency, and flow will provide an identical product each time	Likely to be expensive to set up and inflexible to use; could be a disaster if a product life cycle proves much shorter than expected Modern customers like to see products tailored to their specific needs

In the end, all business operations can be reduced to three words: people, product, profits. Unless you've got a good team, you can't do much with the other two.

Lee Iacocca, US businessman

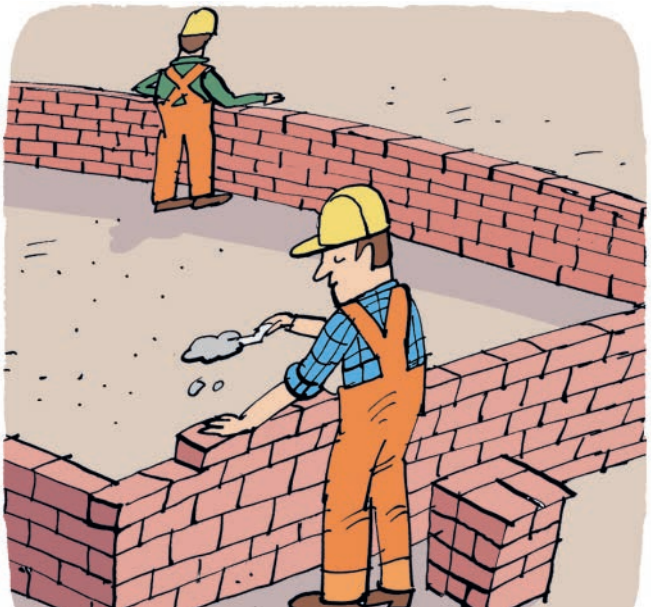
Keeping costs down

Consider the costs involved in building a brick wall:

- Materials: bricks and cement; these must be ordered in the right quantity and at the lowest prices available from suppliers.
- Other direct costs: hiring a cement mixer for a day or two, hiring a skip for the building waste.
- Labour: this is a function of the amount of work involved, the hourly wage of the workers and the productivity of those workers.
- Fixed costs: the fixed costs of the management time taken to win the order, supervise the work and deal with office administration.

To keep costs to the minimum, careful ordering of materials and other supplies is very important.

Every business, though, will be trying to buy at the lowest price and making sure not to buy more than is needed to complete a job. Therefore cost savings through purchasing are rarely crucial.



Labour costs per unit depend on productivity

Far more important is good management of labour costs. Pay rates vary significantly in different parts of the world (see Table 41.2 on page 224), though China is catching up fast.

Table 41.2 Income in China is growing fast

Average annual income (in US$)	2008	2015	2020
UK	46,687	46,647	47,147
Germany	46,633	53,745	51,172
Japan	38,449	37,265	38,515
Hungary	22,674	21,215	20,572
Mexico	17,371	16,516	16,230
China	9,650	14,223	18,172

Source: OECD 2021; data at 2020 $ Purchasing Power Parity

For companies to keep employing workers in Britain, they must find a way to get value out of the high wages being paid. This could come about if workers in Britain have skills that cannot be found elsewhere, for example the ability to write computer games or deal in foreign exchange. People can also be worth the money they are paid if they are highly productive (they produce a lot of work in the time they are employed). This means having high productivity.

Measuring productivity

Gavin is a bricklayer. He can lay 800 bricks in a day and is paid £120 per day. His friend John is a builder who is skilled at many different tasks (plastering, flooring, carpentry) but he can only lay 400 bricks a day. Table 41.3 shows the labour cost per brick if both are paid £120 for a day's work.

Table 41.3

	Pay	Output	Labour cost per brick
Gavin	£120	800	15p (£120/800 = £0.15)
John	£120	400	30p

Productivity is efficiency, usually measured as output per person. In this case, Gavin is twice as productive as John, which means that John is twice as expensive to use. High productivity enables the labour cost to be spread across lots of output. Low productivity (John) means higher labour costs per unit.

Productivity differences can be much bigger than this. In 1999, Renault bought the Romanian car business Dacia. It employed 27,000 people and made 110,000 cars a year. In the same year the Nissan factory in Sunderland, UK, was producing 270,000 cars with just 2,750 people. Table 41.4 shows the productivity difference between Dacia and Nissan:

Table 41.4

	Staff	Output (cars)	Productivity (cars per worker per year)
Dacia	27,000	110,000	4 cars per year
Nissan	2,750	270,000	98 cars per year

Even at the much lower wage rates in Romania, it was far better value to manufacture cars in Britain. Since 1999, Renault has turned this situation around. In 2019, 19,300 Dacia workers produced 736,570 cars, pushing productivity per worker from four in 1999 to 38 in 2019.

In general, higher productivity is one of the keys to success when up against competition. Ways of increasing productivity include:

- investing in up-to-date machinery to help workers work faster, or to replace them with automated equipment or robots
- encouraging staff to work more enthusiastically, and therefore harder and faster; this can be achieved through improved morale and motivation
- encouraging staff to work smarter – to come up with new ways to do things more effectively. Toyota says it receives more than 100,000 employee suggestions per year.

> The three most important things right now are costs, costs and costs. And costs can be summed up in one word: productivity.
>
> *Financial analyst quoted in the New York Times*

Competitive costs mean competitive prices

If high **productivity** keeps costs per unit down, a firm can compete. As shown in Table 41.5, if Ryanair cuts its prices, IAG (the airline group that includes British Airways) will struggle. Ryanair and IAG carry a similar number of passengers, but Ryanair's staff costs per passenger are about one-seventh of those of British Airways.

Table 41.5 The impact of productivity on labour costs per unit (staff cost per passenger)

January to December 2019 (pre-Covid-19)	IAG (British Airways)	Ryanair
Number of passengers flown	47,700,000	149,000,000
Staff costs	£2,529,000,000	£1,107,000,000
Staff cost per passenger	£53.02	£7.43

Drawing the right conclusions

If marketing is about generating revenue, business operations are about delivering to the customer while keeping the costs down. Only then can a profit be made, and without profit no business will last long. Successful operations are as important to services as they are to manufacturing businesses. All customers want good service and reliable delivery. That's equally important whether it is a new Mercedes or a margherita pizza.

Revision essentials

Batch production: producing a limited number of identical products.

Business operations: the section of an organisation concerned with making and delivering what the customer wants.

Flow production: continuous production of identical products, which gives scope for high levels of automation.

Job production: production of a one-off item for a single customer.

Productivity: a measure of efficiency, usually output per person per time period (for example, Nissan UK's 98 cars per worker per year).

End of chapter exercises

1 Tata can sell a car in India for £5,000 that costs Nissan £6,000 to make. In this situation, how might productivity improvements help Nissan?

2 **(a)** Bartex Ltd, a small lighting factory, employs 150 staff and has a monthly output of 180,000 lamps. Calculate the factory's monthly productivity.

(b) A rival based in Hull pays similar wages and has monthly productivity of 1,500 lamps. Outline two ways this might affect Bartex.

3 In the section on measuring productivity on page 224, Gavin is twice as productive as John. Give three possible reasons why this may be the case.

4 Outline two ways that Renault could have improved productivity at Dacia.

5 Read the following extract and answer questions (a) and (b).

A £1.4 million project aimed at boosting the uptake of robots in small manufacturers will investigate ways to more easily change and improve automated systems. Most robots used in industry are highly specialised, making them expensive and unable to quickly respond to new tasks. This has limited their adoption, especially by small and medium-sized enterprises (SMEs) who depend on their agility to be competitive in a dynamic global market.

The UK has also seen significantly lower use of robots compared to other industrial nations. In the UK there are 85 robots per 10,000 employees. This is less than one-tenth of the adoption by countries such as Korea and Singapore, and one-quarter as much as other European nations such as Germany.

(a) Explain the possible effect on UK businesses of having a quarter of the number of robots of countries such as Germany.

(b) There are 5.7 million businesses in the UK. Is £1.4 million going to make much difference to companies' willingness to invest in robotics?

Practice questions

Cambridge vaccine start-up

A Cambridge start-up is attempting to go head to head with drugs giant Pfizer with a new vaccine aimed at eradicating the potentially fatal lung disease caused by *Streptococcus pneumoniae*. ImmBio's new vaccine has progressed from Phase 1 human trials into full clinical development. It could come to market within the next five years. It will rival the Pfizer vaccine Prevenar, the global market leader; 6.4 billion courses of the vaccine are sold each year at a price of around £100 per course.

ImmBio is hoping to rival Pfizer's vaccine

ImmBio chief executive Graham Clarke said that it was only worth going up against the pharmaceutical giants with 'game-changer' products, claiming: 'We are making a product that works, works better than the current product, and is cheaper.' The company claims that their product can guard against multiple current strains and even future mutations.

Streptococcus pneumoniae bacteria are the most common cause of pneumonia, septicaemia and meningitis, and these pathogens kill more infants than malaria, tuberculosis and HIV combined.

ImmBio, which has been working on the vaccine since 2010, has now raised a total of £20 million from a consortium of early-stage investors, including biotech specialist Oxford Technology, to develop its vaccine, which it claims is a completely new approach to bolstering the human immune system.

'People think that big always wins,' said Mr Clarke, who worked at GlaxoSmithKline before joining Immbio. '[Big pharma] has huge sales forces, big marketing, efficient manufacturing and can industrialise their research and development, but it is still true that smaller, more flexible, agile companies have a competitive advantage.'

Total: 20 marks

1 Define the term 'competitive advantage'. (1)

2 Outline one benefit to ImmBio of using batch production for its vaccine. (2)

3 Outline one way in which a big producer such as Pfizer might benefit from efficient manufacturing. (2)

4 Analyse whether ImmBio should set up a factory for producing its vaccine in the UK or somewhere where labour costs are lower. (6)

5 ImmBio is considering two options for taking on Pfizer:

- Option 1: Raise finance from venture capital providers.
- Option 2: Float the business as a plc on the London Stock Exchange.

Justify which **one** of these two options ImmBio should choose. (9)

42 Technology, productivity and production

New technology is a constant force propelling businesses forward. It creates opportunities for new products that people want even though their older versions are still working well ('I must have that new iPhone'). This boosts production, the volume of output. It also creates new ways to manufacture, such as robots, which boost efficiency. This in turn boosts productivity, as measured by output per worker (per unit of time, perhaps per year).

Every generation thinks that its era has seen the most dramatic ever changes to technology, especially this one. Dramatic changes to computing power seem to have transformed everything. The graph in Figure 42.1 is, therefore, surprising: it shows that a long-standing productivity growth trend (of about two per cent a year) pretty much stopped dead in 2007. By the first half of 2021, productivity was slightly above its 2007 level, but in any other 15-year period it would have grown by around 25 per cent. In this time of dramatic technological change, productivity growth has weakened significantly. These figures are for the UK, which has a particular productivity problem, but a similar slowdown has happened worldwide.

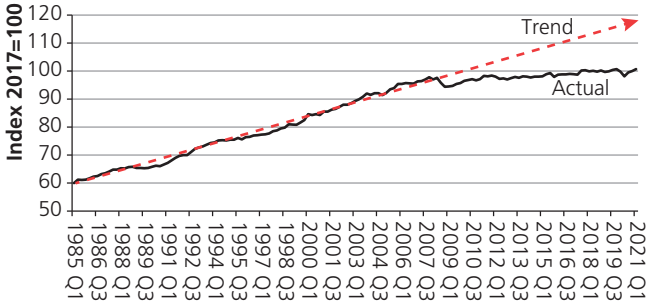


Figure 42.1 UK productivity growth (output per worker), 1985–2021 (Source: ONS)

The benefits of technology

Successful production involves three main things:

- producing the right quantity at the right time
- producing to high standards of consistency and quality
- producing cost efficiently.

High-tech equipment can help with all three. **Automation** (producing by machine) is especially effective at ensuring consistent quality and low labour costs per unit, and the availability of more recent technology, such as **robots**, can make it easier to produce more when needed. Robots don't mind working at the weekend.

Talking point

What do you think are the jobs that are *least* likely to be done by robots in the future?

On the other hand ...

Traditionally factory design in the West was a top-down process designed by engineers and managers. It focused on labour productivity and, therefore, automation. The job of shop floor factory staff was to do what they were told.

Japanese companies, such as Nissan and Toyota, brought a broader view of efficiency to the UK. Instead of focusing on labour costs, the Japanese considered every aspect of waste: materials waste/scrap; energy waste; and the waste of time, labour and materials that comes from quality rejects (which have to be done again).

Recently, sandwich-maker Greencore undertook an efficiency project with Sainsbury's – one of its biggest customers. Focusing on the production lines for two of its biggest-selling sandwiches, a careful assessment plus long discussions with staff identified the potential to save:

- 200 tonnes of lettuce wastage per year
- 200 tonnes of other food waste per year
- 500 tonnes of packaging waste per year.

The savings on food required changes to the way staff worked; the savings on packaging required a redesign of the sandwich box based on the views of the production line workers.

Sometimes efficiency requires new technology – perhaps a machine designed by staff and engineers together – but surprisingly often improvements come from reorganising the workplace based on staff ideas, which are based on logic and a bit of a rethink.

> There is nothing so useless as doing efficiently that which should not be done at all.
>
> *Peter F. Drucker, business guru*

Impact of technology on production

Customers want products that fit their needs and wants at a price they can afford. If technology can help to achieve this, it is valuable. There's always a risk, though, that technology will end up distorting this process. Buy a peach at the roadside in Italy in July and it is completely different to the tasteless fruit sold in the UK in the spring. Technology has allowed the fruit to be stored safely through the winter and transported to the UK. Unfortunately it is no longer worth eating. Like everything else, technology has downsides as well as ups.

A well-run business aims to use technology in a balanced way to match the needs of the customer and the needs of the business. There are four main elements to balance:

- Production costs, which in turn affect the price set for customers. Technology affects production costs through its impact on staff health and safety as much as through improved productivity. The earliest robots in British car factories were paint sprayers, which meant staff were no longer exposed to the danger of breathing in paint particles. Today, the first one into a dangerous demolition site will be a robot not a human. With risks reduced, companies no longer need to pay 'danger money', so costs are reduced and employee health improves. Win–win.
- Productivity can be boosted by mechanising some parts of a production process and automating others. If labour costs per unit fall, that's not only useful this year, it will keep paying the business for the lifetime of the machinery (perhaps five to ten years). High productivity means lower labour costs per unit and, therefore, lower overall costs per unit. That allows the business to either cut prices or enjoy higher profits, which can be invested in even better technology.
- Quality means different things to different people but an important starting point is that customers should get what they want. This means that **flexibility** is important. There is a risk that technology may get in the way of that, as it encourages mass production of the same thing. In a cleverly run business, the benefits of technology are matched with the advantages of human flexibility – giving customers consistent quality tailored to their own requirements.
- Flexibility relates to quality, but also to overall delivery. A menu offers pie and chips, but a request for pie and mash could be met with a smile and a good plate of food. Some large businesses combine an automated till system with a rigid approach to staff decision making, in which scenario the request for pie and mash is turned down because the computer/till says 'no'. This makes no sense to the customer and – in truth – no sense for the business either. But if staff are used to doing only what the rules and the menu allow, their inflexibility is inevitable.

Drawing the right conclusions

From a consumer point of view, better technology is fantastic. Cars that park themselves, Facetime and virtual reality are all examples of things that people want to buy and want to use. But technology can also be a huge distraction within businesses. Inefficiencies in workplaces are usually down to poor communication and poor organisation/management – and jumping at new technology solutions can be a mistake. In the 15 years to 2021, hugely increased computing power provided the opportunity for greatly improved productivity. In fact, as Figure 42.1 (page 227) shows, productivity in the UK didn't improve much at all. So, there's a lot more to improved productivity than technology.

Revision essentials

Automation: using machines that can operate without people.

Flexibility: the ability to switch quickly and easily from one task to another.

Robots: machines that can be programmed to do tasks that can be done by humans, such as welding, spray painting and packing.

End of chapter exercises

1 Look at Figure 42.1 on page 227 and suggest the difference between 'trend' and 'actual' data.

2 Why may 'consistency' in production be a useful benefit of automation?

3 Explain the ups and downs for staff if managers decide to talk to them more about how production could be improved.

4 In the future, technology may allow buses to be self-driven, with no human involvement. Outline one benefit and one drawback to passengers and to bus companies.

5 Read the following extract and answer questions (a) and (b).

In March 2021, Amazon opened its first `just walk out' store in London. Shoppers at Amazon Fresh scan a smartphone app before entering the shop, and then payment is taken automatically when they leave. No queuing; no fishing around for card or phone. Journalists were keen to test the technology – looking for flaws – but no system proved able to beat Amazon. The company is so confident in its technology it says shoppers needn't even check that all the items are accounted for. In America there are already twenty of these outlets and they're called 'Amazon Go'. Research said the brand name 'Amazon Fresh' would work even better in the UK. Since 2021 other UK shops have been desperate to copy Amazon's approach. They all know how much British shoppers value speed – and avoiding queues.

Sources: various.

(a) What impact may Amazon's no-checkout technology have on productivity in its shops?

(b) Outline one favourable and one unfavourable effect of no-checkout technology on retail staff.

Practice questions

Soaring stocks at Morrisons

Morrisons stores are struggling to get to grips with the new 'sales-based' online ordering system. Contributors to a staff intranet have expressed concern about the new software. The new cloud-based system generates orders automatically based on which products are going through the tills. One poster said: 'We are a few weeks in and already have tripled our backstock [stock held on-site in a storeroom]. We have no idea how big our deliveries are going to be day by day and we have gaps everywhere on the shelves.' Another said: 'My store is five weeks into the new system. The backstock has doubled but we've more gaps than ever.'

Morrisons admits that it is trialling a new system and claims that everything is going well. It agreed, though, that some staff might need more training on how to adapt from the traditional order pad system.

Total: 16 marks

1 Outline the problem for a business such as Morrisons when 'backstock has doubled but we've more gaps than ever'. (2)

2 Explain one reason why implementing new technology in the workplace can be disappointing. (3)

3 Outline one reason why Morrisons might have benefited from more flexibility from its staff. (2)

4 Morrisons is considering what to do next about the ordering problem. It is considering two options:

- Option 1: Scrap the new system and return to order pads operated by individuals at work.
- Option 2: Keep going with the new system, but spend more on staff training.

Justify which **one** of these two options Morrisons should choose. (9)

The new online ordering system at Morrisons has led to stock problems

43 Managing stock

Even before the 2020 lockdowns, stock control had been a challenge for many businesses. Toy shops can misjudge the demand for a particular toy one autumn, and realise too late that they will run out of stock before December. It takes six weeks for new **stock** to arrive by ship from China, so there's no time to reorder before Christmas. That means lost profits and disappointed customers. Will they order from Amazon next year instead?

Yet it's at least as risky to over-order. When Covid-19 struck in 2020, French Connection was one of many clothing stores that had to lock down. By the time the lockdown was over in summer 2020, the company had to write off £3.1 million of unsold spring stock. It can never recoup that.

As consumers, we are hugely demanding and quite intolerant. We expect to find every product we are looking for in stock, whenever we want it. Retailers, on the other hand, have to find a balance between too little stock and too much. If all they do is keep masses of stock of every item, their costs will be too high to stay in business.

Bar gate stock graphs

Successful stock management requires the right balance between reliability and cost. Too little stock and customers can be let down. Too much stock and high costs will force high prices (or losses and potential closure).

The traditional approach is shown in Figure 43.1 on page 232. It illustrates how stock levels should ideally be maintained and is based on three things:

1. Level of demand for the product: stock levels of a popular item will need to be kept high, and orders for fresh supplies may have to be sent regularly.
2. Decision on the right level of **buffer stock**: this is the minimum amount of stock the manager thinks should be held at all times. For example, a busy sweetshop might like to keep a minimum of one box of Cadbury's Dairy Milk in stock (48 bars) as customers expect to always find it on the counter.
3. Decision on how often to order from the supplier: a monthly order is likely to be four times the size of a weekly order and might therefore provide bulk-buying benefits.

A busy sweetshop might like to keep a minimum of one box of Cadbury's Dairy Milk in stock (48 bars)

Take, for example, the management of stocks of Heinz Beans at Bob's Grocery. He has steady sales of 20 cans a week and likes to buy four boxes of beans

at a time, each containing 20 cans; his supplier gives him an extra ten per cent discount when buying in bulk. He chooses to keep a minimum of ten cans in stock at all times (his buffer stock).

The **bar gate stock graph** in Figure 43.1 shows how the delivery of 80 cans pushes his stock up from 10 to 90. Then, as shoppers steadily buy the cans, stock slips down from 90 to 70, then down to 50, then 30, then 10. At this point he needs a new batch of 80 cans, which pushes the stock back up to 90. As long as customers keep buying 20 cans a week, and the supplier delivers on time, this process will go on working smoothly.

Graphs such as this one are built into the scanning software used by many shops. When the barcode scanner shows that stocks of Heinz Beans have fallen to ten tins, it can either flash a warning to the shopkeeper or reorder from the supplier automatically.

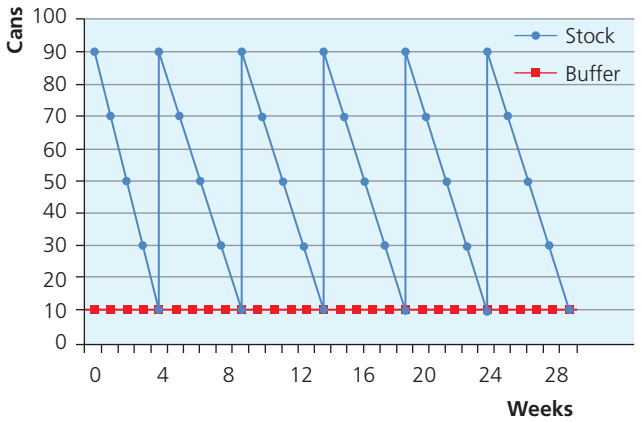


Figure 43.1 Bar gate stock graph for Heinz Beans at Bob's Grocery

Talking point

Should a business feel pleased to sell out of a particular product line?

Just In Time

Buffer stocks help ensure that customers always find what they want on the shelf; however, they cost money and they also take up space. Twenty years ago, a supermarket might have used up 20 per cent of its floor space in stockrooms. These rooms were closed off from the public, just holding stocks. Tesco was one of the first stores to recognise that this was a terrible waste. Why not turn the stockroom into extra sales floor, perhaps to stock non-food items such as clothes?

Tesco started insisting that suppliers should deliver more frequently, but in smaller quantities, creating less need for a big storage room. It also started using **Just In Time (JIT)**. This means ordering extra supplies 'just in time', before the old supplies run out. In other words, it does away with buffer stock. Tesco believes it is so efficient that it does not need a buffer; it will order the right quantities at the right time. In truth, it will sometimes make a mistake, leaving a shelf empty. Clearly its managers find that the benefits of Just In Time outweigh the costs of lower customer satisfaction.

In autumn 2021, a shortage of drivers to deliver fuel turned into a consumer panic at the petrol pumps. With little buffer stock to absorb the panicked extra demand, petrol stations ran out. This led to even greater panic on the part of customers. JIT can look a foolish approach.

> Use of JIT [means] every component has to fit perfectly first time because there are no alternatives available.
>
> *Toyota website*

Table 43.1 Advantages and disadvantages of Just In Time

Advantages	Disadvantages
Eliminating buffer stock cuts storage space, allowing more sales space	A greater risk of running out of stock and therefore disappointing customers
Low stock and more frequent supplier deliveries mean fresher produce	Buying smaller quantities more often means losing out on bulk-buying discounts
Less of the business' capital is tied up in stock	Any mistake or misjudgement could cause out-of-stock and poorer customer service

Drawing the right conclusions

Managing stock is difficult to get right. All it takes is for cake guru Mary Berry to mention 'muscovado sugar' one night on TV and the shelves of Britain will be empty by 10 a.m. the next day. If a business sets its sights on providing fantastic customer service, it may need to set high buffer stocks to ensure that no shelf is ever empty. If, however, the business is focused on low prices and low stocks (like Primark, Aldi or Lidl), a JIT system may be needed to keep costs down. Different firms have different needs and, therefore, different policies.

All it takes is for Mary Berry to mention muscovado sugar one night on TV and the shelves of Britain will be empty the next morning

Revision essentials

Bar gate stock graph: a diagram to show changes in the level of stock over time.

Buffer stock: the minimum stock level held at all times to avoid running out.

Just In Time (JIT): running the business with so little stock that new supplies have to arrive 'just in time' before they run out.

Stock(s): items held by a firm for use or sale, for example components for manufacturing or sellable products for a retailer.

End of chapter exercises

1 Explain the meaning of the term 'stock levels'.

2 Outline one reason why a small grocer's shop might set:

(a) a low buffer stock for fresh grapes

(b) a high buffer stock for Cadbury's Creme Eggs.

3 Look at the bar gate stock graph in Figure 43.1 on page 232 and answer these questions:

(a) In what way does the graph show that Bob wants to keep ten cans in stock at all times?

(b) What is the maximum number of cans of beans held in stock?

(c) Explain what the graph would show if Bob's supplier forgot to deliver the 80 tins of beans.

4 Give two reasons why a factory owner might be worried about ordering raw materials on a JIT basis.

5 Take one of the disadvantages of JIT shown in Table 43.1 on page 232. Explain how it might affect sales at:

(a) a shoe shop in a busy shopping centre

(b) the Manchester United Club Shop, Old Trafford.

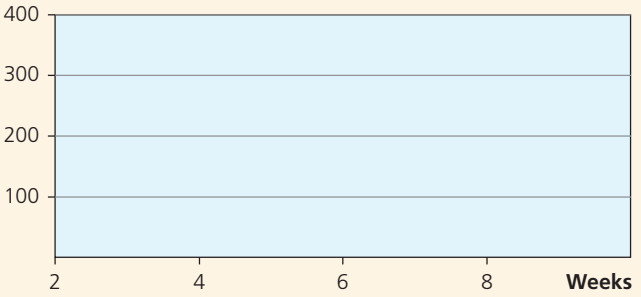
6 Read the following extract and answer questions (a)–(c).

Each week, the mobile phone shop at Meadowhall, Sheffield, sells 90 Samsung phones. It receives its supplies from Samsung at the end of each four-week period. Samsung requires two weeks' notice for delivery (that is, the order must be placed two weeks before the delivery is required). The phone shop likes to have a minimum stock level of 40 Samsung phones.

(a) Draw the firm's buffer stock level on the graph.

(b) Plot the shop's stocks of Samsung phones. The shop starts with 400 units at the start of the month.

(c) Label the graph carefully.



Practice questions

Christmas Switch

Many businesses face highly erratic sales. With Nintendo's Switch, sales in one week can be four times higher than in another week. That would be quite difficult to manage even if the figures were predictable, but some Decembers go better than others. In 2020, Nintendo knew that Sony would be launching its PS5 in the second week of November. The PS5 duly arrived and sold 1,465,000 consoles that week. This might have dented Nintendo sales badly. Just think how hard it must have been for Nintendo to judge its production levels, given the launch of the PS5. Fortunately sales of the Switch proved unaffected.

But Christmas is always a huge issue for console producers. So, how should Nintendo manage its stock control for the Switch? Build up production in September and October to have plenty of stock for the Christmas period, or try to keep stocks low at all times, to keep in with the Japanese idea of JIT?

Total: 13 marks

1 Using the information in Figure 43.2, calculate the percentage increase in Switch sales between the first week in October and the fourth week of November 2020. [2]

2 Outline one reason why big variations in sales make it hard to manage stocks. [2]

3 Nintendo is considering what to do about the huge increase in sales before Christmas. It is considering two options:

- Option 1: Take a JIT approach, producing 500,000 units in a week in October and 1,500,000 in December.
- Option 2: Produce more in September and October to build up a Switch stockpile.

Justify which **one** of these two options Sony should choose. [9]

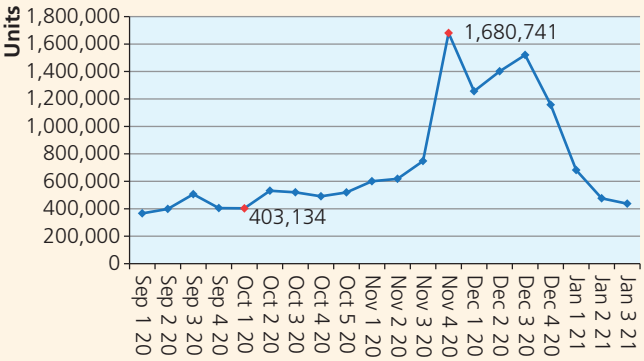


Figure 43.2 Nintendo Switch: global hardware sales Christmas 2020

44 Procurement: working with suppliers

Very few businesses produce 100 per cent of a product or service. Almost all use suppliers. In some cases suppliers may do most of the operational work. Companies that 'bottle' Coca-Cola buy in: the aluminium cans, already printed with the can design; the water; the carbon dioxide used to create the fizz; and the secret Coke syrup (sent from the Coca-Cola factory in America). They may also get a distribution company to make all the deliveries to wholesale and retail customers. So what does the Coca-Cola bottler actually do? Well, it is responsible for **procurement** – finding the right suppliers, ordering the right quantities and checking that everything is done on time and to the right standards. If Waitrose orders a container load of Diet Coke to reach its Bracknell depot at 10 a.m. on a Tuesday morning, does it turn up on time? If not, why not?

For many companies, procurement is a key to success. A homemade ice cream parlour may do all the production operations on-site but still relies on suppliers of fresh fruit, fresh milk and cream, sugar, wafer biscuits and cones, paper cups and plastic spoons, and so on. To run the parlour successfully, all the operations have to be carried out successfully. If you run out of cones and cups, the best ice creams will remain unsold.

A company must therefore select suppliers that deliver the right goods reliably, and must negotiate low enough supply prices to make it possible to run the business economically.

> When consumers purchase a Toyota, they are not simply purchasing a car, truck or van. They are placing their trust in our company.
>
> *Akio Toyoda, president of Toyota*

Building relationships with suppliers

There are five main factors at the heart of the relationship between a company and its suppliers: quality, delivery, **availability**, cost and **trust**. If one had to be picked out of the five, it would be trust.

Quality

If you're making a Bentley, top-quality leather is needed for the car seats. Less obvious is that the quality of supplies may be even more important if you're making a Dacia Logan (one of the cheapest cars on the market). That's because Logans are mass-produced on a conveyor belt, where every component has to be identical or else the car won't fit together. And if there's a faulty gearbox, no one will know until the customer has a breakdown and demands their money back. The point is that high quality is essential to be able to produce low-priced items. And your supplier must know that. The need for quality is fundamental to your business; it is not a minor add-on.

Delivery

Supplies at the right price and of a high quality may be of little use if they arrive late. Failure to deliver supplies on time can bring a manufacturing process to a halt or leave shops with empty shelves. Suppliers' reliability will be easy to assess once a business has started working with them. However, a new business or a business procuring new supplies may need to rely on word-of-mouth reputation to inform its choice. Larger firms will

impose financial penalties on suppliers who prove unreliable, but small businesses are in a weaker position if they try to threaten a supplier.

A further important aspect of delivery is speed and, therefore, a short lead time (the length of time between placing an order and receiving a delivery). This is why suppliers try to locate their factories right alongside their customers. If a spark plug-manufacturer is located right next to Nissan's Sunderland factory, it might be able to get the lead time down to 30 minutes.

Availability

In a similar way to ensuring the right frequency of supplies, firms need to find a supplier with the capacity to cope with widely varying orders. Businesses selling products with erratic demand patterns, caused by changes in the weather or fashion, need to find suppliers that can meet their ever-changing needs. Suppliers must have enough capacity to cope with sudden rush orders. In addition, firms need to find suppliers that can supply at the right time (night-time deliveries may be banned in residential areas, for example).

Cost

Cheaper supplies mean lower variable costs and higher profit margins. Therefore, the price charged by a supplier will be a key factor in the relationship between a firm and its suppliers. Large businesses may be able to dictate prices to their suppliers; because the quantities they purchase may account for most of the supplier's output, it gives a huge amount of power to the buyer.

For small businesses with limited purchasing power, the supplier may have the upper hand. As a result of this, small businesses may be tempted to shop around, looking for the cheapest supplier they can find. This may not always be the most sensible course of action, however; building a long-term relationship based on trust may be more important than short-term cost-cutting.

Trust

Most business transactions are on credit, not for cash. If Tesco wants to order 2,000 cases of Heinz Beans, the bill is unlikely to be paid until 60 or more days after the goods have been delivered. This gives Tesco time to sell the beans, providing the cash to pay the supplier. Small business start-ups will struggle to get the same terms. A newly opened corner shop will not be given credit by Heinz. The supplier will want to be paid in cash until the new business can be trusted to pay its bills. So, a new small firm has to pay up front, placing extra strain on its cash flow.

Trust is crucial in lots of other ways. An aircraft manufacturer such as Airbus wants to keep its ideas for a new plane secret, but it may have to share them with a trusted supplier who is developing a new, lightweight landing gear mechanism. Without trust in the supplier's ability to keep a secret from a rival like Boeing, no business can take place.

> I faced a number of challenges whilst I built Biocon. Initially, I had credibility challenges where I couldn't get banks to fund me ... Even in the businesses where I had to procure raw materials, they didn't want to deal with women.
>
> *Kiran Mazumdar-Shaw, billionaire Indian entrepreneur*

Talking point

Why do may women entrepreneurs still face a credibility problem with some businessmen?

The impact of logistics and supply decisions

Logistics is the science behind efficient movement of materials. In wartime it is about getting the right guns and ammunition to the right troops in the right place at the right time. Your training counts for nothing if you've run out of ammo.

For businesses, it is the same thing. Recently, Airbus was embarrassed to have more than 20 planes 'parked' outside its French assembly factory. A320s were waiting for aero engines to be brought from Pratt & Whitney in the USA, while its A350s were waiting for cabin equipment that had not arrived from a French supplier. Financial experts estimated that Airbus would face delayed cash inflows worth more than €1 billion – just because the physical process of getting parts from A to B was being delayed. Better management of logistics would have helped hugely.

Delays in supply can affect other parts of the production process, as Airbus learned

Well-managed logistics and supply decisions help to achieve:

- a better reputation based on reliability and high-quality service
- lower costs if production can be completed more quickly, and better cash flow if the bills can be presented more quickly
- high customer satisfaction if the right product, with the right quality, is delivered to the right place at the right time, and at the right price; not much to ask!

> Leaders win through logistics. Vision, sure. Strategy, yes. But when you go to war, you need to have both toilet paper and bullets at the right place at the right time. In other words, you must win through superior logistics.
>
> *Tom Peters, business writer*

Drawing the right conclusions

Procurement sounds easy – a bit like going shopping. But for a business to be super-efficient it must get its procurement spot on. It must buy from the right supplier, at the right price, and make sure that it gets supplies of consistently high quality, which are delivered on time. But procurement is about more than just the mechanics of getting things delivered. It is also about trust and business relationships. During the pandemic of 2020/21, any supplier that could get hold of PPE (personal protective equipment) was guaranteed to sell out in minutes; but which buyers had the procurement skills to get the supplies? Not, sadly, the UK government. Overall, China proved to be the PPE winner.

Revision essentials

Availability: knowing how to get the right supplies quickly – just when you need them.

Logistics: ensuring that the right supplies will be ordered and delivered on time.

Procurement: obtaining the right supplies from the right supplier.

Trust: building a business relationship in which both sides know that the other won't let them down.

End of chapter exercises

1. Explain why the cheapest supplier may not always be the best choice.
2. Identify two businesses for which daily deliveries may be absolutely crucial.
3. Briefly explain two problems that may arise when a firm uses a supplier with poor levels of quality.
4. Describe how a car manufacturer such as Volkswagen may benefit from including its component suppliers in the development process when designing a new car.

Practice questions

Christmas toys for dogs

BJK Ltd is a small manufacturer of toys for pets. Having developed a brand new doll for dogs, it is considering which supplier to use for the plastic used in moulding (see Table 44.1). Having started up only 12 months ago, the business has done well and is eagerly anticipating the Christmas rush that will begin soon. The management hopes that the new doll will be a best-seller this Christmas.

Table 44.1 Potential suppliers for BJK Ltd

Supplier	A	B	C
Price per unit (£)	4.20	4.80	4.99
Reject rate (per 1,000 products delivered)	28	18	5
Lead time (days)	7	1	4

Total: 20 marks

1 Identify which supplier offers the best:
   (a) quality
   (b) speed of response. (2)

2 Analyse why lead time would be important to a business such as BJK. (6)

3 Evaluate whether BJK would benefit from using supplier A over Suppliers B or C. You should use your knowledge of the case study as well as your knowledge of business. (12)

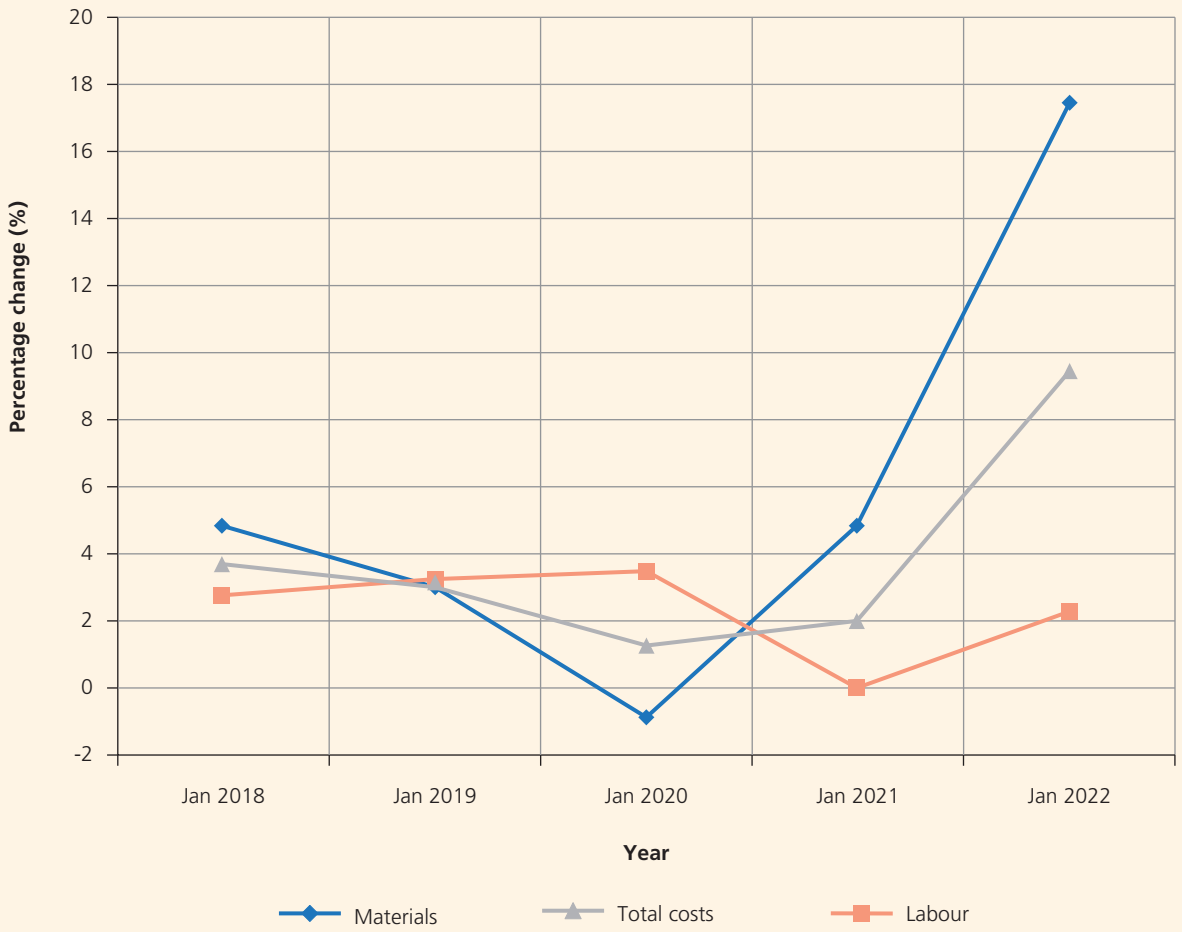
Practice questions

Procurement and inflation

2022 is going to be difficult for any family wanting a new bathroom. One bathroom fitting business says that in the past it would take ten days to get all the fittings, tiles and hand-basins ready for the start of a job. Now procurement is much harder and unpredictable: "shipping time from Italy or Germany is now six to eight weeks. Some suppliers are even quoting 16-20 weeks for what was usually four weeks".

The shortages have come about from a worldwide boom in home-improvement building works since the Covid-19 pandemic. People want an extra bathroom because the family is spending so much more time at home. In many cases families also have far higher savings than pre-pandemic. Two years without holidays abroad has helped people save – but now they want to spend.

The result of this building boom has been huge pressure on the price of materials. As the line graph shows, the cost of materials has been racing ahead in the year to January 2022. Overall inflation in the UK is 5.1 per cent. Inflation in the building sector is much greater and it's likely that pay rises in 2022 will keep it high.



Instead of just coping with shortages, some businesses are taking action. Spanish company Acquabella has invested in improved production methods to boost its output of shower glass panels by 150 per cent. And UK bathroom retailer CP Hart has built up its buffer stocks to minimise supply disruption, holding about £1.5 million more stock than usual.

Total: 20 marks

1 Outline one effect of the information shown in the graph, on households wanting their bathrooms re-done this year. (2)

2 Explain the possible effect of unpredictable procurement on businesses. (3)

3 Analyse whether a switch from batch to flow production might be enough to get Acquabella's production capacity up by 150 per cent. (6)

4 Explain the possible effect of an inflation rate of 5.1 per cent on businesses. (3)

5 Instead of using just-in-time stock control, CP Hart has boosted its buffer stocks. Analyse the possible effects of this on CP Hart's costs. (6)

45 Managing quality

Quality is the ultimate test of a business organisation. Do customers who arrive or phone or email have a positive experience? Do bloggers and social media comments give positive feedback? For producers of goods, quality is about practical matters such as reliability. For service businesses, quality is often about personal things such as politeness and a genuine smile.

With restaurants, quality is partly to do with the product (is it well cooked and served hot?) but also to do with the service: are staff friendly, well trained and on the customer's side? A customer who leaves feeling angry will never return; even a weakly positive response may not be enough. To return, we have to be thrilled. Customers should be delighted, not just satisfied.

> Quality means doing it right when no one is looking.
>
> *Henry Ford, father of all modern manufacturing*

Quality control

Quality control is a system of inspection to try to make sure that customers don't experience a poor-quality product or service.

Many businesses regard quality as a management issue, to be controlled by careful systems. Managers may put in place practices such as:

- factory inspectors at the end of a production line, who check every fifth car or carpet before it is sent to the customer; if several cars fail to start, they might decide to check the whole day's output; any faults found are corrected
- a 100 per cent inspection system, just as Gordon Ramsay does in his restaurants: the head chef checks every plate before it is sent to the high-paying customers; if the steak is slightly burnt, Ramsay throws the whole plate of food away and demands that his chefs start again
- a feedback system, such as a customer feedback questionnaire, which you might find in a hotel room or be given at an airport; this is a check on the final experience enjoyed or suffered by the customer.

The problem that these systems share is that they rarely feel part of the life of the worker. A car worker who is putting left front doors on to Minis all day long cannot even see the end of the line where the inspectors are checking the quality. Similarly, the hotel cleaning staff do not see the feedback questionnaire responses – indeed they may rarely see a hotel guest. Only in the Ramsay kitchen does the chef see his cooking thrown away in disgust by an angry head chef.

Most systems of quality control, therefore, are flawed. They try to put a lid on a problem rather than solve it. They work on the basis of 'acceptable' quality. In effect, they accept that staff will not think much about quality, therefore the managers have to 'sort it out'.

Quality assurance

Although the best businesses create a high-quality culture, this cannot be achieved overnight. If staff treat customers as an inconvenience, the short-term solution may be to use quality assurance. While quality control is a system of checking at the end, quality assurance attempts to build quality into the system. In other words, every member of staff has quality responsibilities. These are set out on paper, often in detail. In this way, everyone knows exactly what they must contribute towards quality.

The hope is that, over time, making individuals responsible for quality will ensure better results. Once staff see quality as their personal responsibility, they may see ways to do things even better. In this way a system of quality assurance can be built into a quality culture.

> Manufacturing is more than just putting parts together. It's coming up with ideas, testing principles and perfecting the engineering, as well as final assembly.
>
> *James Dyson, British industrialist*

Talking point

Discuss whether the quality of your homework would be improved by a thorough system of quality assurance, checking what you do at every stage.

Quality culture

In the ideal business, quality is fundamental to everyone's attitude to work. If you're going to an ice cream parlour, what you want is someone behind the counter who delights in offering you free samples of 'two terrific new flavours' – and enjoys building up the ice cream on the cone to make it look great. When you go to Next, you want the staff to really help you find something that fits well, rather than look frustrated when you don't buy the first couple of things you try on. Ideally, everyone would be enjoying their job of serving you.

Business **culture** means the general attitudes and behaviours among staff within a workplace. When Jürgen Klopp arrived as Liverpool manager, the club had not won the league title for 25 years. He needed to instil a winning mentality. He worked on a cultural shift among the players – away from fear of failure/mistakes and towards a willingness and confidence to take risks. He also worked on establishing a strong team ethos. He encouraged team members to do more together, whether playing golf or playing online games. He wanted players who were willing to fight for one another. In 2019, the team won the Champions League, and in 2020 came the coveted Premier League title. Successful businesses ensure that a quality culture develops among staff. This comes from pride in the business and what it does for its customers.

Table 45.1 looks at what quality means in the production of services as well as products.

> Quality is remembered long after the price is forgotten.
>
> *A Gucci saying that was first coined by Sir Henry Royce of Rolls-Royce*

A customer feedback questionnaire is one system of quality control

Table 45.1 Quality and its importance for the production of goods and services

	Production of goods	Production of services
Quality of initial impact	Well packaged and well presented (posh cars even need to smell new and posh)	Restaurant: food looks and smells great Hotel: room looks clean and smells fresh
Quality in usage	Few or no niggles at the start; reliable and hard wearing	Everything works well/tastes good/proves comfortable (in hotels, a great night's sleep)
Quality of after-sales service	Friendly follow-up call four weeks after purchase; any problems dealt with quickly and cheaply (preferably free)	When calling back for that lost iPhone, staff really care/look/find!

A hospital nurse's quality assurance task may be to record the medication that patients have been given

Quality, cost control and competitive advantage

High-quality production means things are right first time: this means that a job has to be done once and once only. As a result, high quality means:

- less wastage, for example of materials, ingredients or components having to be scrapped
- lower wage bills: staff only use their labour time once per task – if quality is poor, everything has to be done twice; it is the same as when a teacher demands that poorly done homework be redone: it takes twice as much of your time
- fewer managers – each needing a high wage – focused on quality: if staff become excellent at producing high-quality output, fewer quality control staff are needed.

Faced with higher quality and lower costs, a business can start looking at overseas competition. Under British ownership, Jaguar was famous in the USA for the unreliability of its stylish-looking cars. Quality seemed to improve after the takeover by Tata of India, but in recent years Jaguar's quality reputation has fallen back again. By contrast, Japanese luxury carmaker Lexus has a terrific reputation for quality. Table 45.2 shows the contrasts in the carmakers' fortunes in the USA.

Table 45.2 Luxury car sales in the USA, Jaguar vs Lexus

	Jaguar, made in England	Lexus, made in Japan
US sales, Jan–Jun 2020	9,772	85,609
US sales, Jan–Jun 2021	7,283	131,005

Jaguar needs sufficient production quality to make its cars competitive with others on US forecourts.

In many other cases, quality becomes the heart of the product or service's competitive advantage. Examples include Hermès of Paris (bags); Fever-Tree UK (posh tonic water) and Dyson Appliances UK (vacuum cleaners and stunningly expensive hair dryers). If customers want your product for quality reasons, you no longer have to worry about pricing. Broadly, you can charge what you want. That's the secret behind Bentley cars, Burberry coats and Waitrose groceries.

> Almost all quality improvement comes via simplification of design, manufacturing and layout.
>
> *Tom Peters, business writer*

Drawing the right conclusions

High quality is achieved by providing an efficient service: the right product of the right quality at the right time – with a human face. This is hard to attain 100 per cent of the time, because mistakes do happen. The best way to achieve it is to establish a culture of quality based on motivated staff who care about the customers and about the company's reputation.

Once the culture is established, further quality controls may not be necessary. For example, if a fully qualified surgeon is carrying out an operation, no one else will peer over their shoulder to check on the quality. He or she is trusted. However, at Gordon Ramsay restaurants and Toyota car factories, further inspections are carried out to make 100 per cent sure that the quality is spot on. So, a combination of quality culture and quality control is probably the best of all worlds.

Revision essentials

Culture: 'the way we do things round here'; in other words, the accepted attitudes and practices of staff at a workplace.

Managing quality: choosing the right method for achieving high-quality results, then supervising what workers actually do, day by day.

Quality control: putting measures in place to check that the customer receives an acceptable level of quality.

Warranty: the guarantee by the producer that it will repair any faults in a product for a specific period of time – often one year.

End of chapter exercises

1 Explain how 'customer delight' might affect a firm's sales.

2 Outline one possible weakness in a quality-control system based on factory inspectors checking a sample of the finished product before it is sent to customers.

3 Debenhams stores closed forever in January 2021, after years of a worsening reputation for the quality of its goods and service. How might that reputation have affected the business?

4 At school, you and your parents are 'customers'. Outline one example of good and one example of poor quality service that you or your parents experience from the school.

5 Explain why highly motivated staff are more likely to deliver high-quality service.

6 Would a system of quality control or quality assurance be better for:

(a) Boeing, which manufactures passenger aeroplanes

(b) Mars, which produces chocolate bars?

7 Read the extract and answer questions (a)–(c).

If you're thinking of signing up for a gym, it's sensible to check customer reviews. Might you be signing up to a nightmare? Quality of service is crucial, whether it's keeping the changing rooms clean or helping you out when there's a problem, perhaps with your bill. One free online option is to check the reviews on Trustpilot (https://uk.trustpilot.com/). A check on 25 August 2021 gave the following results for the bigger UK gyms and fitness centres (see Table 45.3). Given that gym membership can cost as much as £100 a month, it is clearly worthwhile to do this little piece of research.

(a) Explain which fitness company seems to offer the best quality service.

(b) Explain which fitness company offers the worst quality service.

(c) Quality is a key factor in 'value for money'. What other factors matter in consumers' ratings on value for money? Briefly explain your thinking.

8 Jackson's has a policy of pricing low to attract sales. This forces it to cut a few corners, but owner Tess Jackson is proud that her business has the second highest sales volume in the industry. The industry number one is GFH Ltd. Tess has just hired a new manager who used to work for GFH Ltd. This has allowed her to find out about her rival's customer service figures.

	Jackson's	GFH Ltd
On-time deliveries	88.4%	93.6%
Damaged deliveries	2.4%	0.65%
Customer returns	3.1%	1.05%
Customer satisfaction	78.4%	91.7%

Which two of the following conclusions can be made from these figures?

(a) The low-price policy at Jackson's is definitely working.

(b) Tess can feel proud that only 3.1 per cent of customers send their goods back.

(c) Tess urgently needs to look into why 21.6 per cent of her customers are unsatisfied.

(d) There is a serious risk that repeat purchase levels at GFH Ltd will fall in future.

(e) Tess should discuss these figures with all her staff, inviting ideas for improvement.

Table 45.3 Reviews for bigger UK gyms and fitness centres

Fitness company	Virgin Active	David Lloyd Leisure	Fitness First	Gym Group	Pure Gym
Stars (out of 5)	3.8	3.4	3.0	4.0	4.0
Review % saying 'excellent'	43%	35%	15%	56%	52%
Review % saying 'bad'	33%	34%	73%	9%	12%
Number of reviews	1,350	43,361	675	10,142	12,434

Practice questions

Quality control at Toyota

The cornerstone of Toyota's quality-control system is the role of the team members in the production process. The principles on which Toyota was founded are employed at the Georgetown plant in the USA. Toyota involves its team members by:

- encouraging an active role in quality control
- utilising employee ideas and opinions in production processes
- striving for continuous improvement (known as *kaizen* in Japan).

New-product planning emphasises a product that is as defect-free as possible. In other words, Toyota designs quality into the automobile. Quality control during production ensures that the correct materials and parts are used, and that they are fitted with precision and accuracy. This effort is combined with thousands of careful inspections performed by team members during the production process.

Team members on the line are responsible for the parts they use. They are inspectors of their own work and that of co-workers. When a problem on any vehicle is spotted, any team member can pull a rope – called an andon cord – strung along the assembly line to halt production. Only when the problem is resolved is the line restarted. This process involves every team member in monitoring and checking the quality of every car produced.

In 2015, Toyota announced a multi-million dollar expansion of the Georgetown plant and 750 new jobs producing their upmarket Lexus models alongside the Toyotas. The company said this was a tribute to the high quality standards at Georgetown. In 2021, for the first time ever, Toyota outsold Ford and General Motors to become the USA's market leader.

Total: 20 marks

1 Define the term 'quality control'. (1)

2 State one way in which Toyota is ensuring high quality output. (1)

3 Analyse how Toyota may benefit from the high quality standards it achieves. (6)

4 Evaluate the impact of Toyota using a quality control system at Georgetown. You should use the information provided as well as your knowledge of business. (12)

46 The sales process

As she walked into the Italian bakery, she was greeted with: 'Hello, I remember you … Mrs Draper?' She smiled and said: 'It's great to be back … I moved two years ago and I miss your Nutella croissants.' The baker grabbed a croissant, disappeared, then returned with a coffee plus croissant. He said: 'Please have the coffee on me. Nice to see you again.' She paid £1.20 for the croissant, sighed and left with a wave.

To be effective, customer service must be:

- rooted in a clear understanding of what customers really care about
- practical and cost effective enough to ensure that it can be kept going regularly
- based on a genuine wish to help, rather than an attempt to seem helpful
- offered at the right time in the right way at the right place.

Great customer service is a wonderful thing, but there is far more than that to the **sales process**. To succeed with sales, a business must make sure it provides:

- strong **product knowledge** and, therefore, helpful advice
- speedy and efficient service
- **customer engagement**
- responses to **customer feedback**
- excellent **post-sales service** (or after-sales).

> In the world of internet customer service, it's important to remember your competitor is only one mouse click away.
>
> *Doug Warner, vice president at Hewlett Packard*

Product knowledge

Customers expect that staff will be sufficiently well trained and well motivated to have good knowledge of the products and services being offered. No one would be impressed if, at a cocktail bar, the barman had to look up the ingredients for a Mojito or a Martini. Similarly, supermarket customers want staff to be able to show them where the Marmite is located. In certain businesses, product knowledge goes from being desirable to essential. A travel agent knows you can get from Zurich to Milan by plane, but that it is cheaper and more convenient by train.

To get staff to have strong product knowledge, certain things are essential:

- Good training: at the famous River Café restaurant in London, waiters help chefs to prepare ('prep') the food in the morning, and are flown out to meet different suppliers in Italy each year; their product knowledge is – naturally – amazing.
- Loyal staff that stay for years: if staff only stay for three to six months, they can never get a rich understanding of the product and services; well-managed businesses that pay fairly and treat staff well can get the loyalty that's needed.
- Staff who are committed to customers: this is affected by good recruitment, good training and by the degree of commitment staff feel towards the business as a whole. Some staff in a health food shop may care hugely about healthier eating and living – making them care about being knowledgeable.

Good service can be a higher priority than cost

Speed and efficiency of service

Good customer service is designed for the customer, not the company. It is efficient because it works well, works quickly and gives the customer the sense of being cared for. With good service a call to a company is answered by the receptionist who knows that the managing director is out today. With bad service, a call puts you into a voicemail loop and you wait several minutes listening to tinny 1990s music; only then do you get through to someone at a call centre 25 – or 10,000 – miles away. That person tries to put you through to the managing director – and keeps failing.

Efficient service:

- gets products to you exactly when you want them …
- in good condition …
- and if there is something wrong, it will be sorted out as soon as possible and in the right spirit (if you leave a jacket in a shop, it would be great for them to contact you, instead of you having to figure out which shop you left it in).

Good service may cost the customer extra, but that is fine as long as it represents value for money. It must relate to what customers want and what they are willing to pay for. A discounted 'Upper Class' flight on Virgin Atlantic to New York is priced at £2,800 return. This is about six times the price of a standard class ticket. For that you get a seat that doubles as a bed, an on-board massage and better food. It is hard to see that this *can* be value for money – yet Upper Class seats are usually full. Some people (or their companies) are happy to pay it.

Ryanair, meanwhile, offers minimal customer service. It is a no-frills airline based on low costs and low prices. There is no free food or drinks on board, and rarely a

smile from staff. Yet if all you want is to get to Spain and back cheaply, quickly and efficiently, Ryanair may be ideal, as you can see in Figure 46.1 below.

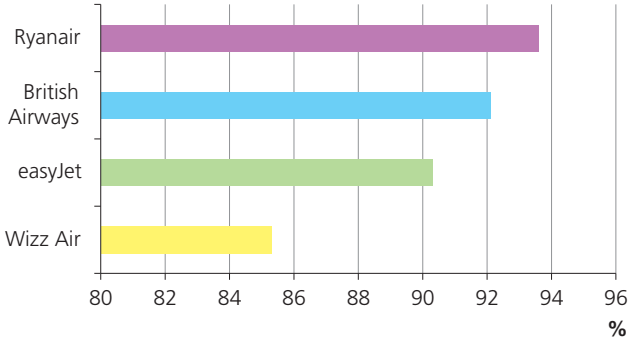


Figure 46.1 Percentage of flights arriving on time at British airports, May 2021 (Source: Statista 2021)

> Being on par in terms of price and quality only gets you into the game. Service wins the game.
>
> *Tony Alesandra, US entrepreneur*

Customer engagement

In the world of social media, it becomes possible to try to keep customers engaged with the business on a semi-permanent basis. This is exactly what happens with football supporters. They go to the ground to see a match once every fortnight, but may receive half a dozen Tweets a day from the club, telling of a new player signed, or the result of the Man of the Match vote. These are engaged customers. It may never be possible for an ordinary business to stimulate the fervour of the football supporter, but customer engagement is an important idea. Here are some examples:

- A customer at Burberry is sent regular updates on new fashion styling, images from the latest fashion shoot with Brooklyn Beckham and occasionally a free ticket to a Burberry event at London Fashion Week. The hope is that the customer feels 'part of' Burberry, rather than just a customer.
- In spring 2021, TikTok boasted 17 million UK users spending an average of an hour a day on the app. Chinese online fashion business SHEIN has proved a very astute user of the medium. Its link-up with influencer Addison Rae has helped build its profile and its huge sales success.

Influencer Addison Rae

- Customer engagement existed long before social media, of course. For decades, people round the world have wanted a Hard Rock Cafe (a US music-themed restaurant chain) London/Miami/Tokyo T-shirt. In this case the customer engagement came first – by word-of-mouth. Only later did the company see the chance to turn this into revenue and profit.

Responses to customer feedback

Years ago, customer feedback meant two things: feedback to the business ('I thought the steak was a bit tough') and word-of-mouth, that is, telling friends and family. Even though bad news can spread pretty quickly, the power of word-of-mouth was a relatively slow burner. By comparison, a post on Tripadvisor is much more powerful – and worrying. Well-run restaurants or hotels post replies to the customers who have left comments. This is especially worthwhile if the comment was critical. Apologising for a dripping

tap or lukewarm lasagne makes sense, especially if you – the boss – follow up the complaint and make sure it doesn't happen again.

For a business, the reason to provide great customer service is because it keeps customers coming back. It can cost a lot of money to persuade new customers to come: advertisers believe that people need to see a TV commercial at least five times before it has any effect, and five national TV commercials on ITV can easily cost £600,000. So, it is madness to risk losing these people through poor service.

> Profit in business comes from repeat customers; customers that boast about your product and service, and that bring friends with them.
>
> *W. Edwards Deming, the business gurus' guru*

Drawing the right conclusions

However good the customer service was at the time, poor after-sales service can ruin the effect. You paid £2,000 to a plumber just two months ago, but there's a small leak from the sink's waste pipe. You phone to ask for a speedy visit to sort the problem. Promises aren't kept and weeks go by. It is clear that, with the money banked, the plumber can't be bothered with your little problem. You're furious and take back the nice things you said to neighbours about the plumber – but the plumber may know that there are always other customers out there. In a small town a plumber can't get away with this, but in Birmingham or London, it is no problem.

For a well-run business that cares about its long-term reputation, good after-sales service is vital. It is reasonable to say that it is important in life to make a good impression when you say hello, as well as when you say goodbye.

Revision essentials

Customer engagement: the attempt to make a customer feel part of something rather than an outsider.

Customer feedback: comments, praise or criticisms given to the company by its customers.

Post-sales service: service received after the purchase is completed, perhaps because something has gone wrong or as a way of promoting customer engagement.

Product knowledge: how well staff know all the features of the products and the service issues surrounding the products, such as the precise terms of Kia's seven-year warranty on its new cars.

Sales process: all the factors required to ensure that an interested customer becomes a buyer.

End of chapter exercises

1. Explain the importance of staff product knowledge for a customer going to buy their first new car.
2. Why may speed of service matter more to some customers than others?
3. Suggest two ways in which customer engagement might be promoted by a local kebab shop.
4. Explain the damage that might be caused to a company's profits if it responds bitterly to customer feedback.
5. Explain how a low-cost airline might benefit from improving its post-sales service.
6. Read the following extract and answer questions (a) and (b).

   There are three keys to successful selling:

   Emotion: Consumers like to think they are making logical decisions (those trainers are so comfortable), but their decisions are also influenced by emotion (love that brand; Terry's got those). Successful sales staff

recognise the emotional triggers – and play on them.

Trust: Especially when a large purchase is made, for example, a new car, the buyer must trust the salesperson. So the seller works hard to build up a rapport, perhaps pausing in the sales process to chat about family.

Rationalisation: Even though emotion and trust are critical, the buyer must be given a way to think they are being logical in their purchase (yes, it's good value for money; or, yes, I'm getting a £120 discount by buying today).

(a) How would strong product knowledge affect a salesperson's success with these three factors?

(b) How would success in using these three factors affect customer engagement at a clothes or footwear shop?

Practice questions

£210 million of Victorian Plumbing

Google 'Victorian Plumbing' and click on the website and you'll see a dull presentation of dull items from baths to washers. All on sale at supposedly bargain prices. There's nothing obviously Victorian about it – nor does it seem sparklingly up to date. But in 2020, its revenue was £210 million (all in the UK), profits were up by 153.4 per cent to £26.1 million and it was able to pay £8.88 million in wages to its 369 staff.

It's still a private limited company, but probably worth between £500 million and £1 billion. And, it's 75 per cent owned by a guy who started it in his 20s, in 2000. Today the only other shareholders are his brother and their mum and dad, because the business has been able to grow without bringing in any outside shareholders – and very little debt. Mark Radcliffe can be very proud of his achievements.

Mark is still very involved in the business, but has said that: 'In the first six years I did everything myself because I was self-taught, but eventually I learned to give people autonomy. Within the next two years we aim to make the business international, but I am combining my work and personal time more sensibly. I try to do the school run twice a week.' He understates the autonomy involved as he now has a racing car and is trying to break in to high-level motor racing. The person running the business was once his assistant, later promoted to business manager and now the chief executive. Stephanie is taking the business forward.

Mark's entrepreneurial streak began aged 20, starting a business selling mobile phone accessories. The £80,000 he received when he sold the business was an important source of capital to help Victorian Plumbing grow. In its early years, Victorian Plumbing grew slowly, as people got used to buying things online. Sales then shot ahead in the 2009 recession – and again in the 2020 lockdowns. How has it been so successful? The key is its rating for customer service. Over 122,000 reviews on Trustpilot give the company a score of 4.3 out of 5, which it categorises as 'excellent'. By comparison, Currys PC World has a score of 3.2 – the 'average' category. If Stephanie can make sure the customer service remains strong and the overseas expansion works well, there may be plenty more profits to fund a fleet of racing cars.

Sources: Various, including Companies House

Total: 25 marks

1 Calculate the average annual income for staff at Victorian Plumbing. (2)

2 Analyse how Victorian Plumbing could benefit from Mark giving autonomy to Stephanie. (6)

3 (a) Calculate Victorian Plumbing's total costs in 2020. (2)

(b) Explain how the business might cut its total costs in order to boost its profit. (3)

4 Evaluate the importance to Victorian Plumbing of providing good customer service. (12)

Exam-style questions on Topic 2.3

Don't rush; check your answers carefully.

Questions 1, 2 and 3 are based on the bar gate stock graph for JB Grocers below.

1 Which **one** of the following seems to be JB Grocers' maximum stock level for baked beans? (1)

- **(a)** 100 tins
- **(b)** 500 tins
- **(c)** 300 tins
- **(d)** 9 tins

2 How many tins are delivered to the shop every two weeks? (1)

3 Which **two** of the following statements are reasons why JB Grocers might want a delivery every two weeks instead of once a week? (2)

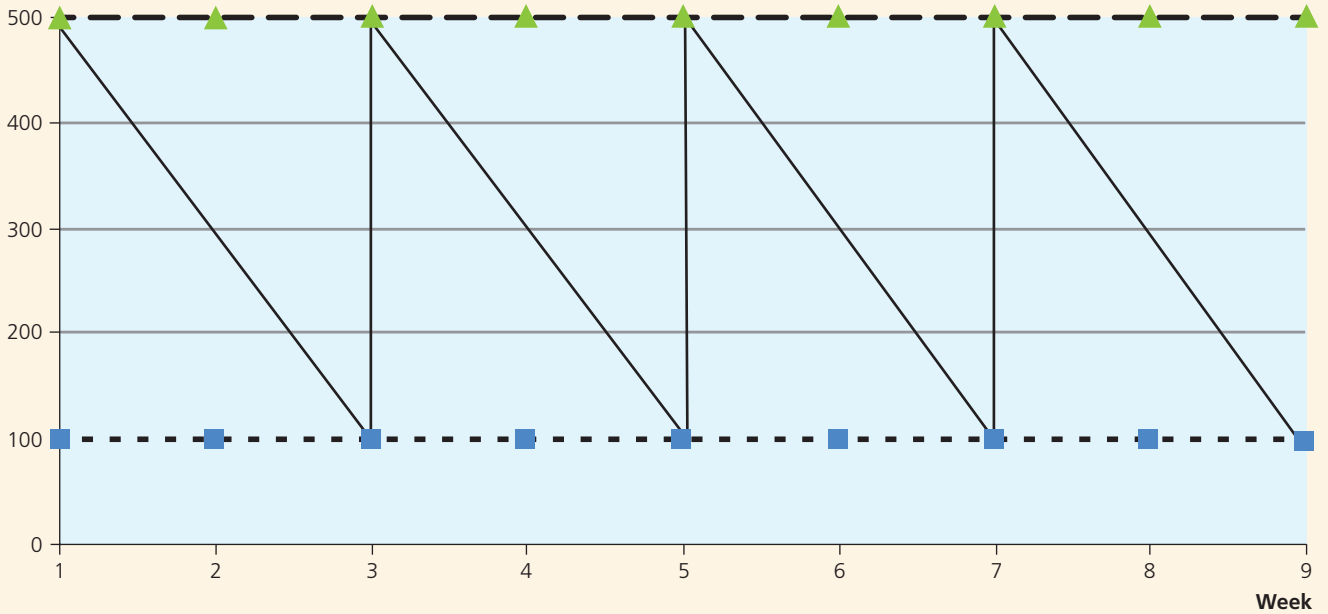
- **(a)** To lower their average stock levels.
- **(b)** To make sure the maximum stock capacity is fully used.
- **(c)** There may be a large delivery charge per order.
- **(d)** So that stocks don't fall below the buffer level.
- **(e)** Bigger orders may mean bigger discounts from suppliers.

4 Which **one** of these is a definite result of using a system of quality control? (1)

- **(a)** It guarantees that every customer enjoys products of the highest quality.
- **(b)** It ensures that everyone in the business cares about quality.
- **(c)** It keeps the costs of quality management down to the minimum.
- **(d)** It ensures that products are inspected at the end of the production line.

5 Which **one** of the following is a reason why good quality management might provide a business with a competitive advantage? (1)

- **(a)** Higher quality may cost more, but the business doesn't *have* to push the price up.
- **(b)** Customers might come to see the product as superior to rivals.
- **(c)** High-quality products might worry competitors, making them back away.
- **(d)** Using quality assurance systems provides more paperwork and, therefore, better record keeping.



Bar gate stock graph for JB Grocers

Questions 6, 7 and 8 are based on this information about BMax Ltd.

Between them, the 20 staff at BMax Ltd produce 600 chairs a week. The productivity level of the staff is twice as high as that at Balex, a major competitor.

6 Which **one** of the following is the productivity level of the BMax workforce? (1)

(a) 30 chairs per person per week

(b) 600 chairs per person per week

(c) 300 chairs per person per week

(d) 12,000 chairs per week

7 Which **two** of the following reasons might explain why BMax has higher productivity than Balex? (2)

(a) Better management at BMax may mean their staff are more motivated.

(b) BMax may make more use of job production than at Balex.

(c) Balex managers are more reluctant to spend on new technology.

(d) Balex managers may be better at procuring on-time supplies than BMax.

(e) Balex managers may use mass production methods to good effect.

8 Which **one** of the following is a problem Balex will have in competing with BMax? (1)

(a) It will struggle to produce enough to meet customer demand.

(b) Balex may lack the reliability BMax shows to its customers.

(c) Low productivity at Balex will mean a lower break-even point.

(d) Balex will have much higher labour costs per chair than BMax.

9 How might improved quality management allow a business to control its costs? Identify **one** reason. (1)

(a) It should reduce the amount of re-work needed on defective output.

(b) It will provide quality inspectors to make sure employees' output meets set standards.

(c) It will make quality inspectors redundant.

(d) It encourages staff to take as long as necessary to produce top quality work.

10 Discuss the importance to a growing business of keeping productivity high. (6)

47 Business calculations

When Topshop collapsed in 2020, there were huge arguments about who or what was to blame, including about excessive dividends and low contributions to the pension scheme. At the heart of the matter, though, was that Topshop was no longer a profitable business. The numbers no longer added up. It had to close.

Starting and running a business is a fascinating mix of problem solving, decision making, dealing with people and dealing with numbers. Even businesspeople who dislike calculations soon learn that some key calculations are critical. Among the most important are:

- **gross profit margin**
- **net profit margin**
- **average rate of return**.

It is important for businesses to make the right calculations

Gross profit margin

Gross profit is the difference between a product's selling price and what it cost the business. Trainers bought for £100 from JD Sports cost the business £45 to buy from the factory. So, JD Sports' gross profit is £55. That profit figure may sound greedily high, but remember that gross profit doesn't include the background running costs of the business – fixed costs such as shop rents, staff salaries, spending on advertising, heating, lighting and much more.

The following formula is used to calculate gross profit margin:

$$\text{gross profit margin} = \frac{\text{gross profit}}{\text{revenue}} \times 100$$

So, in the case of the JD Sports trainers, a £55 gross profit on a £100 selling price means a gross profit margin of:

$$\text{gross profit margin} = \frac{£55}{£100} \times 100 = 55\%$$

Of course, even if each JD Sports product has a 55 per cent gross margin, it doesn't mean that the whole business achieves 55 per cent. Not everything is sold at full price, or else there wouldn't be January and July sales. As Table 47.1 (see page 253) shows, in 2021, JD Sports plc achieved a gross margin of 48 per cent. Comparable figures for Sports Direct and New Balance show how well JD Sports did. The higher the gross profit margin, the easier it should be to achieve a satisfactory net profit margin.

Table 47.1 Gross profit margins at selected sportswear companies

	Sports Direct (Frasers Group plc) Year end 25/4/2021	**JD Sports plc (footwear & fashion) Year end 30/1/2021**	**New Balance UK Ltd (owned by New Balance USA) Year end 31/12/2019**
Sales revenue	£3,625m	£6,167m	£325m
minus Cost of sales	£2,094m	£3,206m	£244m
equals Gross profit	£1,531m	£2,961m	£81m
Gross profit margin	$\frac{£1,531m}{£3,625m} \times 100 =$ **42.2%**	$\frac{£2,961m}{£6,167m} \times 100 =$ **48.0%**	$\frac{£81m}{£325m} \times 100 =$ **24.9%**

To improve a gross profit margin, a company has just two things to work with: either raise the price (charge £105 for that £45 item) or find a way to get the supplier price down (keep charging £100, but pay the supplier only £42 instead of £45).

- Increase the price: this is possible if the business has sufficiently distinctive brands to make people willing to pay the extra instead of switching to a rival. In the case of JD Sports, a sustained commitment to fashionable brands and smart stores has strengthened the brand image and, therefore, prices.
- Cut the price paid to the supplier: this can be done by:
  - renegotiating with the existing supplier for a lower price, perhaps because good sales mean that you are buying more items per month
  - getting a bidding war going between two suppliers, that is, get them to compete for your business; the lowest cost per unit wins
  - rethinking the item, perhaps using slightly cheaper materials or redesigning it so that it is simpler and, therefore, cheaper to make.

Net profit margin

Net profit is what's left after all the fixed running costs are taken away from gross profit. Trainers bought for £100 from JD Sports may yield a £55 gross profit. But running a shop doesn't come cheap, and JD Sports also has to pay for the fixed costs of running the head office. So net profit margins are always smaller than gross margins. So, it may be that the company calculates that an item priced at £100 needs to pay £45 towards the fixed running costs, in which case the net profit on the jacket would be £55 – £45 = £10.

The following formula is used to calculate net profit margin:

$$\text{net profit margin} = \frac{\text{net profit}}{\text{revenue}} \times 100$$

So, for JD Sports this £10 of net profit would mean a net margin of:

$$\text{net profit margin} = \frac{£10}{£100} \times 100 = 10\%$$

Even if individual trainers have a 10 per cent net profit margin, it doesn't mean that the whole business achieves 10 per cent. The figures in Table 47.2 for JD Sports and Sports Direct were greatly affected by the 2020–21 pandemic. In the case of Sports Direct, virtually its entire gross profit was eaten away by fixed running costs, from rent to the costs of financing the business.

As Table 47.2 (see page 254) shows, in 2021 JD Sports achieved a net margin of over 10 per cent. The comparable figures for Sports Direct and New Balance show that JD Sports did brilliantly in such a tough year. The results for Sports Direct and New Balance were poor enough to raise the question: why are they bothering to be in business at all? Perhaps the end of lockdowns will give them the performance boost they need.

Table 47.2 Net profit margins at selected sportswear companies

	Sports Direct (Frasers Group plc) Year end 25/4/2021	JD Sports plc (footwear & fashion) Year end 30/1/2021	New Balance UK Ltd (owned by New Balance USA) Year end 31/12/2019
Gross profit	£1,531m	£2,961m	£81m
minus Fixed running costs	£1,522.5m	£2,637m	£100m
equals Net profit	£8.5m	£324m	(£19m)
Net profit margin	$\frac{£8.5m}{£1,531m} \times 100 =$ **0.56%**	$\frac{£324m}{£2,961m} \times 100 =$ **10.94%**	$\frac{£-19m}{£81m} \times 100 =$ **-23.46%**

To improve a net profit margin, a company has just two things to work with: raise the gross profit or find a way to cut the fixed running costs (perhaps move the head office somewhere cheaper, or sell off that corporate jet the directors love to fly around in). Other ways to cut the fixed running costs include the following:

- Consider whether the business might be quicker on its feet if there were fewer layers of management, either in-store or at head office. Fewer layers means faster decision making, and a lower salary bill.
- Cut back on that sponsorship of Formula 1 motor-racing. Does it really generate enough sales to be worth the cost? Isn't it a bit of an expenses-paid jolly for directors and senior managers?
- And does pay have to be quite so generous for directors? The Executive Chairman of JD Sports earned £5 million in 2020/21. Was that really necessary? Or deserved? Shopfloor workers on minimum wage probably think not.

Talking point

Red Bull spends more than $100 million a year sponsoring its Formula 1 racing team. Can it really generate enough sales to cover the cost?

Average rate of return

For senior managers, a regular part of the job is making decisions. Should we invest £50,000 on an automated car wash at our petrol station? Should we spend £12,000 on a forklift truck to save staff having to carry so much (and speed things up)?

To help make these decisions, a useful tool is average rate of return (ARR). It is a calculation of the average yearly profit on an investment as a percentage of the **sum invested**. So, if it is the car wash, we'd work out the average yearly profit (let's say £5,000) and calculate that as a percentage of the £50,000 set-up cost. In this case the ARR would work out as:

$$\frac{£5,000}{£50,000} \times 100 = 10\% \text{ a year}$$

That figure could then be compared with other possible investments of the petrol station's cash. If opening a Krispy Kreme doughnut franchise could generate an ARR of 15 per cent a year, the higher profitability would mean you'd choose it in preference to the car wash. Of course, if you had the cash and the space to do both, you might do that.

In an exam, the figures for ARR will be presented to you in a table, as shown in Table 47.3 on page 255. This sets out:

- the initial outlay (the cash the investment costs the business)
- an estimate of the net yearly profit generated by the investment.
- It may also provide you with a column showing the accumulated profit; the key figure there is the bottom right-hand corner, which shows everything that is expected to happen over the lifetime of the investment.

Table 47.3 shows the estimated annual profits from an £80,000 investment in a four-year Krispy Kreme franchise.

Table 47.3 The first stage in calculating average rate of return

Time period	Yearly profit	Accumulated profit
NOW: the initial investment	–£80,000	–£80,000
Year 1	+£10,000	–£70,000
Year 2	+£35,000	–£35,000
Year 3	+£45,000	+£10,000
Year 4	+£38,000	+£48,000

If the investment makes £48,000 profit over a four-year period, it has made an average of £12,000 profit per year. Therefore, the formula used to calculate ARR is:

$$\text{average rate of return} = \frac{\text{average yearly profit}}{\text{initial investment}} \times 100$$

So, for the Krispy Kreme franchise:

$$\text{average rate of return} = \frac{£12{,}000}{£80{,}000} \times 100 = \textbf{15\% a year}$$

The ARR is 15 per cent a year. This figure can be compared with other uses of cash, whether by leaving it in the bank (which might only earn three per cent interest a year) or by investing it elsewhere in the business.

Drawing the right conclusions

Below is a summary of ARR. Make sure you can recall what it is and how you calculate it.

1. What is ARR? It is a calculation of average yearly profit expected as a percentage of the sum invested.
2. Why do it? To make it easy to compare different investment options – to see which is the most profitable.
3. How do you do it?
   - Identify the total profit over the lifetime of an investment, for example £48,000.
   - Calculate the average yearly profit by dividing by the number of years, for example £48,000 / 4 years.
   - Use the ARR formula to calculate the average yearly profit as a percentage of the sum invested, for example, (£12,000 / £80,000) × 100 = 15 per cent.
4. How do you evaluate the result? It is a measure of profitability, so the higher the better. The least you'd want from a business investment is that it must provide a higher percentage than keeping the money safe in a bank account, that is, it must make a better return than the interest rate.

Revision essentials

Average rate of return (ARR): average yearly profit as a percentage of the sum invested. This shows profitability and can be compared with the interest rates available on bank deposit accounts.

Gross profit margin: gross profit as a percentage of sales revenue or, for an individual item, gross profit as a percentage of the selling price.

Net profit margin: net profit as a percentage of sales revenue or, for an individual item, net profit as a percentage of the selling price.

Sum invested: the cash put at risk when investing in new equipment or a new product.

End of chapter exercises

1 Look again at Table 47.1 on page 253. Explain one possible reason why New Balance's gross profit margin was so much lower than that of Sports Direct and JD Sports.

2 Outline what would happen to profits if a business allowed its fixed running costs to grow too fast.

3 Look at the data from Domino's UK in Table 47.4.

Table 47.4 Revenue and profit at Domino's

	Jan–Jun 2020	Jan–Jun 2021
Sales revenue	£246.9 million	£277.8 million
Net (operating) profit	£45.8 million	£59 million

(a) Calculate Domino's net profit margin for January to June 2020 and 2021.

(b) Comment on whether the first half of 2021 was good or bad for Domino's.

4 Annual profits on an investment of £600,000 are shown in Table 47.5.

Table 47.5 Forecast annual profits

	Annual profits (£ thousands)
Year 1	+100
Year 2	+400
Year 3	+400
Year 4	+180

(a) Using the information in Table 47.5, calculate the average rate of return.

(b) The company has another investment possibility that could yield a 25 per cent return a year. Should it go ahead with both?

5 VZ Ltd calculates that investing in a new robot will generate an ARR of 5.5 per cent over the next five years. To finance the investment, VZ would need to borrow £100,000 at 6.5 per cent a year.

Which one of the following gives a logical reason to go ahead?

(a) The 6.5 per cent interest will give a 5 per cent profit per year.

(b) VZ believes the robot should have a useful life of 10–12 years.

(c) The ARR calculations were based on cash flows estimated by VZ's factory manager.

(d) The cost of capital may rise further over the five-year period.

Practice questions

The £65 thrill ride: Zip World

Adventure company Zip World operates the world's fastest zip wire. Its Velocity 2 zip wire in Penrhyn Quarry, North Wales, can reach 125 miles an hour. It also runs Europe's highest giant swing at its site in the Snowdonia mountains. Started five years ago, Zip World now has revenues of £14 million a year generated by 400,000 customers. At the start of January 2019 it raised extra venture capital, valuing the business at £45 million.

Despite these huge sums of money, Zip World director and co-founder Sean Taylor seems happy to focus on the business. He says: 'Having built an exciting brand in the adventure tourism sector, we are focused on scaling up and will be looking to buy additional sites as part of our plans to expand.' At the moment the expansion is focused on the UK, but the long-term prize could come from growing globally.

To travel the 1.5-mile Velocity 2 will cost you £65. That might sound a lot, but this superfast zipwire cost £600,000 to build. And when you think that people are willing to spend over $250,000 for the thrill of going up into space in a rocket, the world's fastest zipwire is perhaps not too pricey.

Zip World may have spotted a new trend among holidaymakers. Theme parks are perhaps too predictable – Zip World provides unique experiences in beautiful, natural settings. They report that many young adults take the 2.5-hour train journey from London – just for the thrill of Velocity 2. This may be the start of something big.

Tripadvisor review (reviewer from West Sussex):

> Me and my boyfriend booked to do velocity today. Was unsure as it was quite expensive at £60 each. Staff are all so friendly and helpful. Did the small zipper first and it did 40mph then got on the truck and they take you to the top of the mountain to the big one. Everyone goes two at a time. I was terrified and screamed most of the way down but it was brilliant! 90–100mph for a mile – crazy.

Table 47.6 Summary of business performance, Zip World Ltd

	2016	2017	2018	2019
Sales revenue	£7.1m	£8.99m	£11.5m	£12.01m
Net profit	£1.54m	£1.01m	£2.36m	£1.77m
Average staff numbers	153	243	221	235
Visitor numbers	212,000	327,000	398,000	Unavailable

Total: 22 marks

1 **(a)** Using the information in Table 47.6, calculate Zip World's net profit margin for 2017 and again for 2018. (3)

(b) Analyse what factors might boost Zip World's net profit margin in the future. (6)

2 Outline why the directors of Zip World set up the business as a private limited company. (2)

3 Sean is considering investing in a new zip wire for kids. It will cost £200,000, but make a profit of £80,000 a year for the next four years. Calculate the average rate of return. (2)

4 Sean Taylor might try to expand the business into the USA in the coming years. More finance would be needed. He sees two options:

- Option 1: Sell more share capital to the existing venture capital provider.
- Option 2: Turn Zip World into a plc and float it on the London stock market.

Justify which **one** of these two options Zip World's bosses should choose. (9)

48 Understanding business performance

Managers use quantitative data on a daily basis to support, inform and justify decisions. Teachers do this to check on student progress and decide whether to push for grade 6 or 7. Companies use data to:

- check whether sales are rising in line with the market as a whole
- check whether staff 'illness' is consistently higher in some departments than in others
- help decide whether to promote Karen or Carl to the position of area manager
- help decide whether or not to keep the Northampton branch of a bakery open
- help decide whether to launch Smarties in China.

> There are lies, damned lies and statistics.
>
> *Benjamin Disraeli, former prime minister*

> The statistics on sanity are that one of every four Americans is suffering from some form of mental illness. Think of your three best friends. If they're OK, it's you.
>
> *Rita Mae Brown, author*

Information from graphs and charts

A **line graph** is hugely important in business because it shows trends over time. All businesspeople know that China and India are two of the fastest-growing countries on the planet but, if you're a top manager at Jaguar Land Rover, the graph shown in Figure 48.1 holds crucial information. Back in 2001, China and India had similar-sized car markets. Added together they were smaller than the UK. Fast-forward to

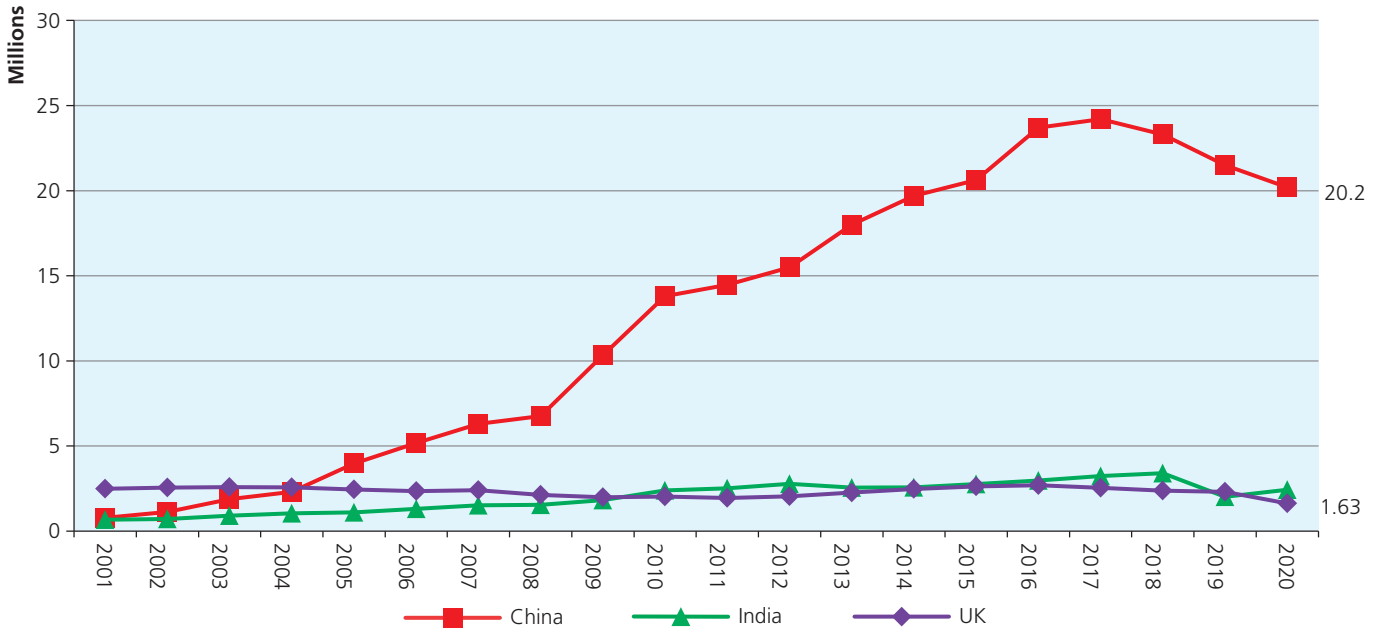


Figure 48.1 Yearly global sales of passenger cars, 2001–20 (Source OICA and press releases)

2020 and you can see the transformation. India's is now bigger than the UK's, and China's is by far the biggest on the planet. Luckily for Britain, Jaguar Land Rover made a big push into China in 2010, which has been very successful. They saw what was happening and acted. Figure 48.1 also shows that car sales were slipping even before Covid-19 hit in 2020. Perhaps fears about climate change were affecting buying habits.

Business decisions are about the future, so line graphs are hugely helpful. By looking at the sales growth in China between 2001 and 2010, Jaguar Land Rover was able to anticipate that there was more growth to come. In 2010, Jaguar Land Rover sold 25,000 cars in China. In 2020, it was 111,000; that growth represented thousands more jobs in the UK.

A **bar chart** can be presented horizontally or vertically. It is a useful way to present different sets of data in a way that makes them understandable. In the bar chart presented in Figure 48.2, a comparison is made between Brazil, India, China and the UK. The data shows how well these four countries are preparing for the future. The UK does reasonably well on all three criteria, but not brilliantly. Brazil does especially poorly on preparing education for tomorrow. China comes top on all three measures.

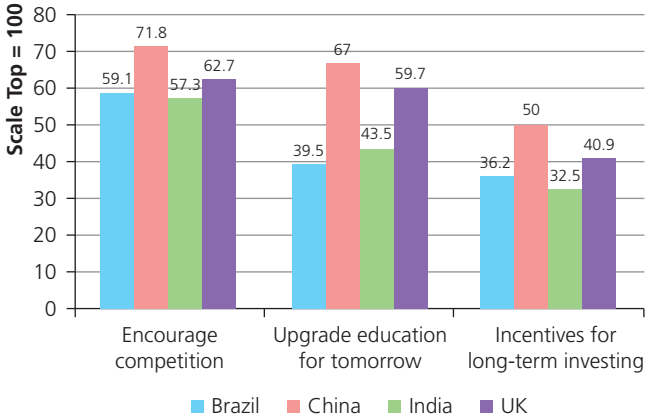


Figure 48.2 Performance on economic transformation priorities (Source: Global Competitiveness Report 2020)

A **pie chart** gives a simple look at proportions, such as market share. In Figures 48.3 and 48.4 on page 260, the share of world sales of passenger aircraft is easy to take in at a glance (there are only two producers: the USA's Boeing and Europe's Airbus). In 2004–05, Boeing was still a powerful player with a 47 per cent share; by 2018–19 the Europeans were clearly on top with 62 per cent: it is an important development in a market worth hundreds of billions of pounds a year – and worth tens of thousands of jobs in the UK.

Table 48.1 Advantages and disadvantages of line graphs, bar charts and pie charts

	Line graphs	Bar charts	Pie charts
Advantages	Good for data shown over many time periods Good for looking at how one factor affects another, e.g. sales in pounds and money spent on advertising	Good for data shown over two or three time periods Good for comparing the size of several different items, e.g. populations of the ten biggest countries	Good for showing proportions, e.g. Cadbury's share of the UK chocolate market Size of the circle can be made proportional to the quantity it represents
Disadvantages	Too many lines can be confusing, so it can only be used to compare two or three series of data A risk of oversimplifying in assuming that an upward line will stay upward in the future	Cannot easily be used to compare data over many time periods If there's too much data it becomes confusing to look at	Pies show big differences clearly, but for small differences a bar chart can be clearer Cannot show trends over a number of years

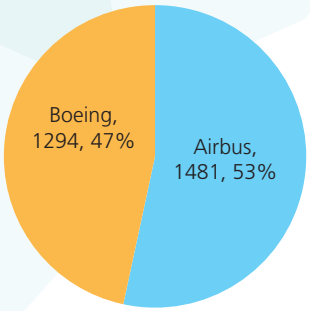


Figure 48.3 Global orders for large passenger planes in 2004–05

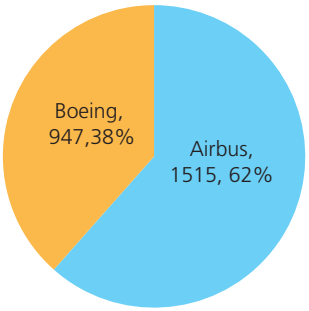


Figure 48.4 Global orders for large passenger planes in 2018–19

The different ways to present data have different advantages and disadvantages. They are presented in Table 48.1 on page 259.

Financial data

Important business measures of financial data such as profit margins and average rate of return (ARR) were dealt with in the previous chapter. Decisions can also be made using the following calculations:

- Measuring the profit or loss on a specific deal, or the profit/loss made by one part of the business. When Theo Paphitis bought the struggling retail chain Robert Dyas for £10 million, he estimated that he could achieve annual profits of £2.5 million a year. In fact, within one year he'd pushed the profits up from £186,000 to £3.2 million.
- Measuring the break-even point. If one shop in a chain is making losses, the owner might set the store manager the goal of achieving a break-even level of sales. After reviewing how difficult it was to achieve that goal, the owner can then decide whether to try harder to achieve profits, or whether it is time to close down that shop.
- Forecasting cash flow. When a successful fashion designer decides to expand by taking on more staff and moving to bigger premises, the key problem is likely to be short-term cash flow. Expansions such as this cause huge extra cash outflows that occur before extra cash inflows can start to be generated.

In business, before every decision the effect on profit and the effect on cash flow should be calculated. When both look OK, the decision can go ahead.

Marketing data

Marketing data includes a company's own figures on sales and marketing spending, and the results of primary market research. Secondary market research would usually come under the heading of market data.

To help inform a decision on whether or not to go ahead with a new product launch, a business might get an independent survey done. A research company would go out with a sample of the product and a bank of questions about likes and dislikes. If a high enough percentage of people in your target market say yes, you'll go ahead and launch. As the launch might easily cost £5 million (and could fail), it makes sense to spend perhaps £50,000 on some serious primary research.

Talking point

If evidence shows only one in five new products succeeds in the long term, should Cadbury give up on producing new chocolate bars? Justify your answer.

Market data

Table 48.2 (page 261) shows spending on soft drinks in the UK and China. It provides a clear idea of the UK market size (£13,635 million in 2020) and trends in the UK market between 2014 and 2020 – there has been little growth in the UK over this period of time. By contrast, China's figures show huge growth, with sales per person rising by 43 per cent between 2014 and 2020. As people become wealthier in China, treats become a greater priority. Knowing the size of China's population (1.4 billion at the time of writing), one can even work out the total size of the Chinese soft drink market from China's 2020 figure:

£83 per person × 1.4 bn = £116.2 bn

This is about eight times the size of the UK market. And analysts Frost & Sullivan forecast a further 40 per cent increase in sales in China by 2024.

Table 48.2 Sales of soft drinks in the UK and China, 2014–20

	UK		China
	Total sales (£ millions)	£ per person	£ per person
2014	£13,710	213	58
2015	£13,742	212	61
2016	£14,021	213	65
2017	£14,299	216	69
2018	£15,410	232	73
2019	£15,237	229	78
2020	£13,635	204	83

Data such as this enables the managers of a global brand such as Pepsi-Cola to choose their priorities. If they have £200 million to spend advertising the brand worldwide, perhaps it is more sensible to support the growth in China than to try to sell more in the UK. Businesses collect market data such as this from secondary sources such as Frost & Sullivan, or public sources such as government statistics.

The use and limitations of financial information

To know what to do next, managers need to be clear on what's going right and wrong currently. To understand the company's current business performance, the manager may analyse:

- current trends in market share; are we beating or being beaten by our rivals?
- current trends in profit; are we making more or less per month than last year?
- current trends in our cash balances at the bank; are our cash flows pulling the business down or pushing it up?

However, there are limitations to the value of all this data. A manager is quite likely to assume that, if things are going well, it is because of brilliant management decisions. But if things are going badly it is for some outside reason, such as bad weather or the uncertainties caused by Brexit. Collecting good data is not enough. It must be evaluated rigorously and, perhaps, independently. Data is only as good as the person using it.

The other key use of data is for making business decisions. Clearly the same applies: if calculations are misinterpreted, or key warning signs ignored, the result will be awful. Interestingly, this doesn't always hurt the decision maker. Some decisions take so long to evaluate that the manager responsible is long gone: promoted or off to a rival. In 2016, Australian retail giant Wesfarmers paid £340 million to buy Homebase, a struggling UK retail chain. Convinced it could transform the business, Wesfarmers invested heavily to 'improve' the stores. But sales fell and profits disappeared. By 2018, the company realised it had made a dreadful mistake and sold off the Homebase business for £1. Quite some mistake.

The limitations of using financial data to make business decisions include the following:

- The raw figures may be unreliable or even biased. A good example is market research data if the questions have been written too positively.
- Talking to staff can reveal insights that figures can't capture: there may be losses at the Barnsley branch because the manager is a bully and staff keep leaving. Closing the branch down might seem right according to the financial data, but a day spent talking to staff would reveal a different, better decision.
- Sometimes a business needs to be patient. Although the iPhone was an overnight successes, the original Apple iPad took a little while to get going. Look at Figure 48.5 on page 262 to see how weak the sales were in the first year. By 2016, Apple executives could have had doubts about the product's future. In fact, after the end of 2018, iPad sales started to increase again – and boomed hugely in lockdown 2020/21 (Apple stopped publishing sales figures after 2018, so the detail can't be shown).

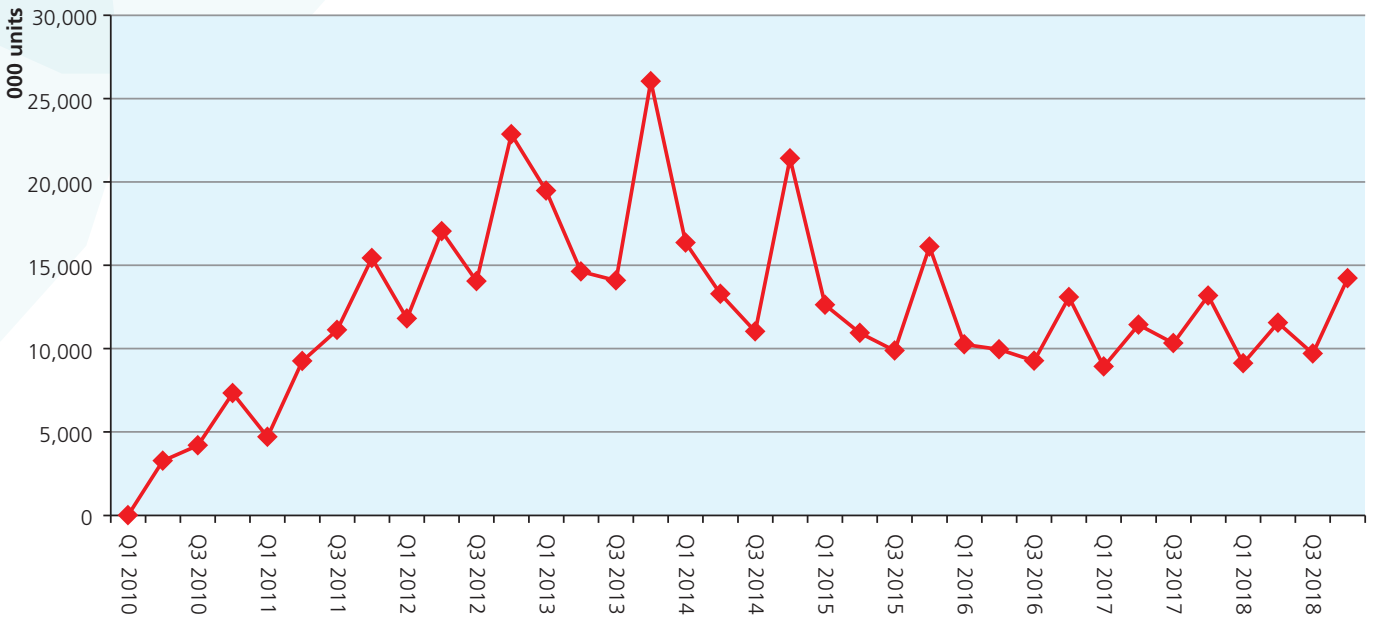


Figure 48.5 Global quarterly sales of the Apple iPad, 2010–18 (Source: Apple Inc. accounts)

Drawing the right conclusions

To understand **business performance** it is important to be able to read columns of figures and interpret graphs and charts. Companies use graphs to make their performance look impressive, so it is a useful skill to be able to see when there's a degree of exaggeration.

Quantitative skills

As you will have gathered from this chapter, managers employ a range of quantitative skills to make business decisions. In your exams you too will be required to apply quantitative skills to business contexts. The specific skills you will be expected to be able to apply can be found in Appendix 2 on page 31 of the Edexcel GCSE Business specification. They comprise calculations including:

- percentages and percentage changes
- averages
- revenue, costs and profit
- gross margin and net profit margin ratios
- average rate of return
- cash-flow forecasts.

You will also be required to interpret quantitative data relating to business contexts and use it to inform business decisions. This includes:

- interpreting graphs and charts
- profitability ratios
- financial data (profit/loss/average rate of return/cash flow forecasts)
- marketing data
- market data (market share/changes in costs/changes in prices).

All of these skills are covered in this book and if you answer the 'Exercises' and 'Practice questions' at the end of each chapter there are plenty of opportunities to practise applying them.

Revision essentials

Bar chart: data presented so that the height of the bar represents the quantity involved; good for making comparisons.

Business performance: ways of measuring how well a business has done in the recent past (often the basis for setting targets in the future).

Line graph: data presented as lines, making it easy to identify trends, especially if time is on the horizontal axis.

Pie chart: data presented in a circle, with each slice of the pie representing a proportion of the whole; good for proportions of a total, for example market share.

End of chapter exercises

1 In 2020, Lucozade retail sales were £302.1 million out of total sales of £1,350 million in the UK market for sports and energy drinks.

(a) Calculate Lucozade's sales as a percentage of the whole market for sports and energy drinks.

(b) State whether a bar chart, a pie chart or a line graph would be the best way of showing this.

2 Outline one possible reason why Airbus was able to move from a 53 per cent share of sales in 2004–05 to 62 per cent in 2018–19.

3 Given that spending per person on soft drinks was £204 in the UK and £83 in China in 2020, how is it possible for China's market size to be eight times that of the UK?

4 Explain why financial data might not help a business make a decision about whether to spend £5 million on a sponsorship deal with a successful Olympic athlete.

Calculation exercises

1 Percentage and percentage change

1.1 A business has total weekly sales of £15,000. One of its products sells £10,500 a week. Calculate the percentage that one product represents as a percentage of the total.

1.2 A company's profits fall from £42,000 last year to £29,400 this year. Calculate the percentage change.

1.3 Last year a company had 60 staff. This year it employs 81. Calculate the percentage change in its staffing.

2 Averages

2.1 In the past three years a company's profits have been: £42,000, £12,000 and £66,000. What has been the average level of profit per year?

2.2 In a warehouse employing 50 people, actual attendance at work has varied as follows:

- 4 weeks ago: 44
- 3 weeks ago: 46
- 2 weeks ago: 39
- 1 week ago: 34

Calculate the average weekly attendance.

3 Revenue, costs and profit

3.1 A hamburger stall sells burgers for £5. Each one costs £2 to make and running the stall costs £400 a week. Its weekly sales are 500 burgers.

(a) Calculate the revenue.
(b) Calculate the total costs.
(c) Calculate the profit.

3.2 A company sells 200 items a week at £12 each. Its variable costs per unit are £4 and weekly fixed costs are £1,200.

(a) Calculate the profit.
(b) Calculate the break-even point.
(c) Calculate the new profit if sales rise by 50 per cent

4 Gross and net profit margins

4.1 In the past six months a company has £90,000 of revenue, with £40,000 cost of sales. After taking away other operating expenses and interest, the business was left with £12,000 of net profit.

(a) Calculate the gross margin.
(b) Calculate the net margin.

4.2 A business with revenue of £200,000 has a gross profit margin of 40 per cent. Calculate its cost of sales.

5 Average rate of return

5.1 A business forecasts that a £50,000 investment should make £15,000 profit a year, after allowing for all costs. Calculate the average rate of return.

5.2 A company estimates that a £20,000 investment will bring in £40,000 profit over the next four years (after allowing for the cost of the investment). Calculate the average annual rate of return.

6 Cash flow

6.1 A business has £4,000 of cash at the start of a month. Its cash inflow is £5,000 and outflow is £2,000. Calculate the amount of cash it has at the end of the month.

6.2 A business starts a month with £8,000 of cash. £10,000 is paid out but it ends the month with £9,000 in cash. Calculate that month's cash inflow.

Practice questions

Pop goes the market

PepsiCo is the world's biggest and most profitable snack food business. In the UK it owns Walkers Crisps and in the USA there's the multi-billion dollar brand Lay's. So popcorn producers took notice when PepsiCo announced the UK launch of its major US brand Pop Works in September 2016. The timing looked brilliant as the UK popcorn market had grown 26 per cent in the previous 12 months.

Fast forward to 2018 and the situation looked very different. Despite its power to achieve high distribution levels in supermarkets, PepsiCo's popcorn brand had been a flop in the UK. Pop Works was 'delisted' by Asda in March 2018, and by May that year Sainsbury's was the only major grocer to still stock the product. The 2017 market leader was Butterkist, with sales of £36 million.

PepsiCo seems to have launched the wrong product into the UK market – and at the wrong time. From a near-trebling of the market between 2012 and 2015, by September 2016 the popcorn boom was over. And own-label popcorn supermarket sales were taking over from brands.

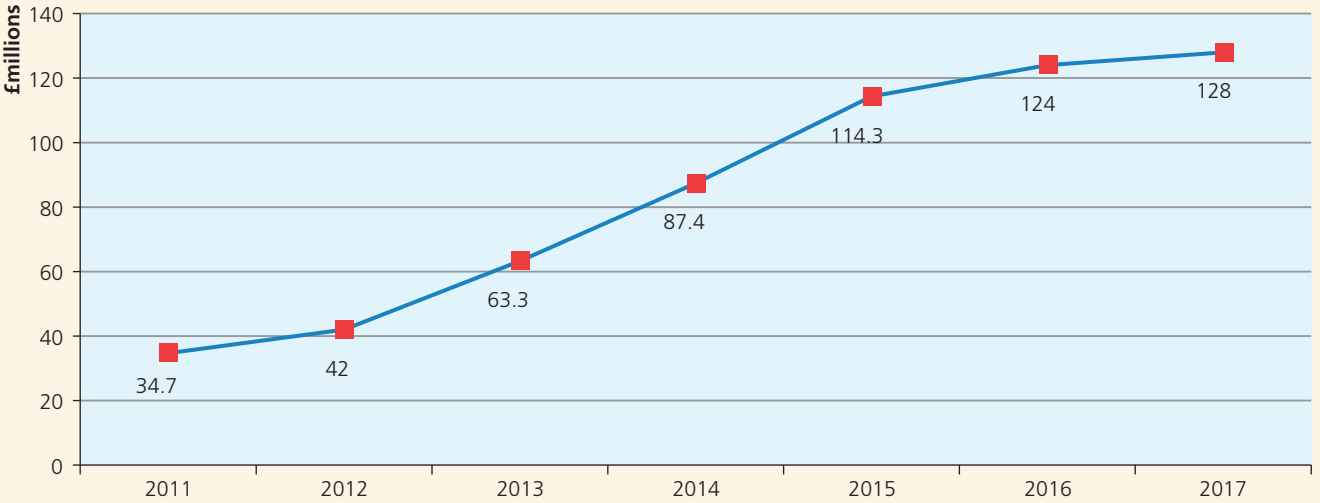


Figure 48.6 UK popcorn market size and growth

Table 48.3 gives an indication of popcorn's remarkable ability to generate high prices and high profit margins. But perhaps consumers are realising that popcorn can be really poor value for money.

Table 48.3 Popcorn prices – value for money?

Product/brand	Retailer	Price	Weight	Price per 100 g
Propercorn for Kids	Tesco	£1.89 for 5	12g × 5	£3.15
Metcalfe's Skinny Popcorn	Tesco	£1.49	70g	£2.13
M&Ms Peanut	Tesco	£1.50	140g	£1.07
Kettle Chips (salt & vinegar)	Tesco	99p (half-price offer)	150g	£0.66
Island Sun Popping Corn	Tesco	99p	500g	£0.20

Total: 20 marks

1 Using the information in Figure 48.6 and in the text, calculate Butterkist's market share in 2017. Show your workings. (2)

2 Analyse how changing consumer needs may have affected PepsiCo's launch of Pop Works in the UK. (6)

3 Evaluate why there may be higher profit margins in selling popcorn than in selling potato crisps in the UK. You should use the information provided as well as your knowledge of business. (12)

Exam-style questions on Topic 2.4

Don't rush; check your answers carefully.

1 Which **one** of the following is the best definition of net profit margin? (1)

(a) Profit after fixed overheads are taken away as a percentage of total revenue.

(b) Profit before fixed overheads are taken away as a percentage of total revenue.

(c) Profit after fixed costs are deducted as a percentage of total costs.

(d) Profit after deducting the margin of safety as a percentage of total revenue.

2 Which **two** of the following are valid conclusions based on the information in the graph below? (2)

(a) Since 2003 the position of Airbus has been getting better and better.

(b) The fall in orders in 2020 should make Airbus cut its rate of production/deliveries for 2021/22.

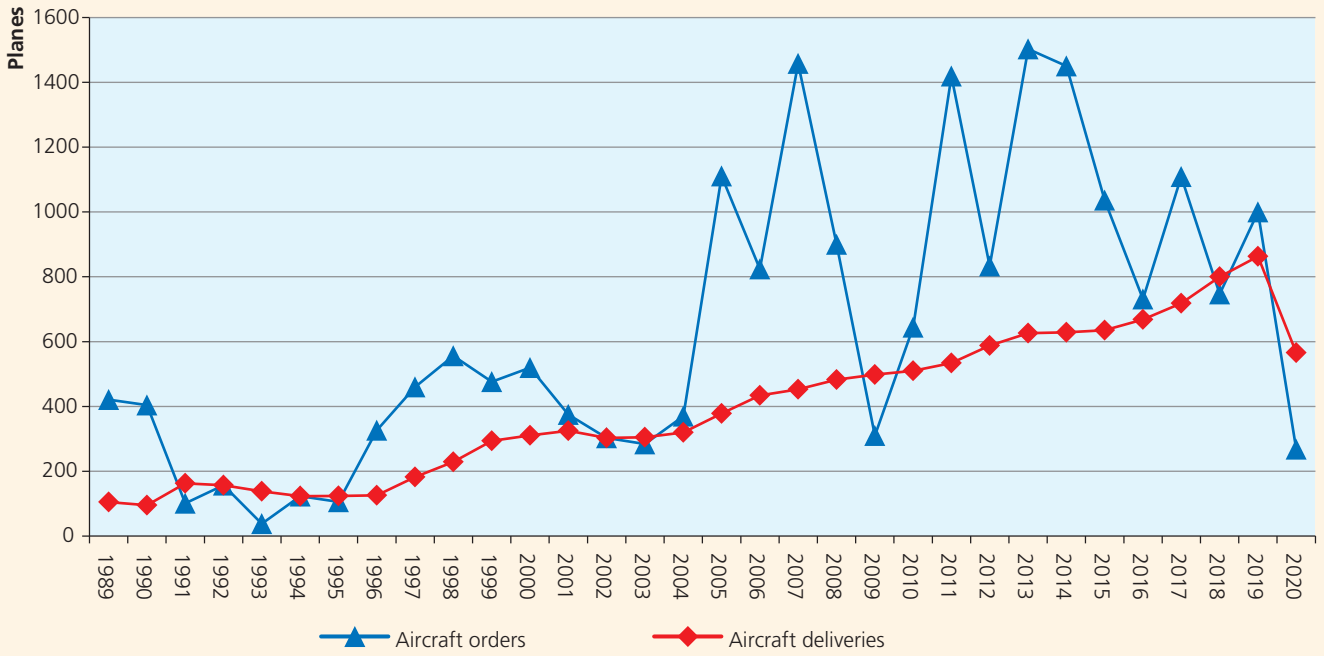
(c) Deliveries in 2018 were six times higher than in 1997.

(d) The Covid-19 pandemic hit sales and production of Airbus planes in 2020.

(e) There were 400 more aircraft orders than deliveries in 2017.

Questions 3 and 4 are based on the following table of figures.

	Last year	This year
Sales revenue	£140,000	£165,000
Cost of sales	£70,000	£80,000
Cost of fixed overheads	£50,000	£55,000
Net profit	£20,000	£30,000



Airbus aircraft orders and deliveries, 1989–2020

3 Which **one** of the following is a correct statement based on the figures? (1)

- **(a)** The net profit margin this year is 10 per cent.
- **(b)** The net profit margin last year was 14.29 per cent.
- **(c)** Managers should have to answer for the serious rise in 'cost of sales' this year.
- **(d)** The net profit margin this year is an increase of 50 per cent.

4 Which **one** of the following is the correct figure for the gross profit margin last year? (1)

- **(a)** £85,000
- **(b)** 100 per cent
- **(c)** £70,000
- **(d)** 50 per cent

5 Which **one** of the following are all needed to calculate the average rate of return (ARR)? (1)

- **(a)** The number of years, the sales revenue, the net profit and the total cash inflows.
- **(b)** All net cash flows over the investment's life, the initial outlay and the number of years.
- **(c)** The initial outlay, the gross profit, the fixed overhead costs and the number of years.
- **(d)** The initial outlay, the break-even point and the number of sales made.

6 ABC Ltd and BFG Ltd are direct rivals in the market for publishing computer games magazines. The figures given in the table show the latest position for each business.
Which **two** of the following are conclusions that can be taken from these figures? (2)

	ABC Ltd (£ millions)	BFG Ltd (£ millions)
Sales this year	£12.5	£16.0
Market size this year	£50.0	£50.0
Sales last year	£12.0	£14.4
Market size last year	£48.0	£48.0

(a) ABC's sales have risen by 20 per cent this year.

(b) The market hasn't been growing, which makes it hard to succeed.

(c) BFG's sales are rising faster than ABC's.

(d) BFG's share of the market has risen from 30 per cent last year to 32 per cent this year.

(e) The total publishing market seems to be worth £98 million.

7 Which **one** of the following is the key advantage of using Average Rate of Return (ARR) when making a decision? (1)

(a) It shows how quickly you get your investment money back.

(b) It shows the profit you make over the lifetime of an investment.

(c) It shows the per cent annual profitability of an investment.

(d) It shows the difference between the profit and the rate of interest.

Now try this discussion question.

8 Discuss whether a growing business could ever have a net profit margin that is too high. (6)

49 Organisational structures

Is there a 'pecking order' among your group of friends? Is there someone who makes the decisions for your group, or who tells the others what to do? You might have someone who is in charge, who makes the final decisions. You might have a newer member of the group who is always the person told to go and make the drinks! If there is, you probably have what is called an informal hierarchy within your group. Without this structure and defined roles, you might never get anything organised and get together for any nights out!

In businesses it is no different: they have structures too. For a small firm there may just be the owner/boss and a few staff working for him/her. In a large company, the structure will be more complex. It will help identify who does what job and who is in charge of whom.

There may be a pecking order among your group of friends

An **organisation chart** is a diagram showing the structure of a business. Let's take the example of a small business employing five workers. The structure will be straightforward, as shown in Figure 49.1.

The chart shows that there is one person at the top of the organisation, who makes all the decisions, and there are five workers below who follow the instructions given.

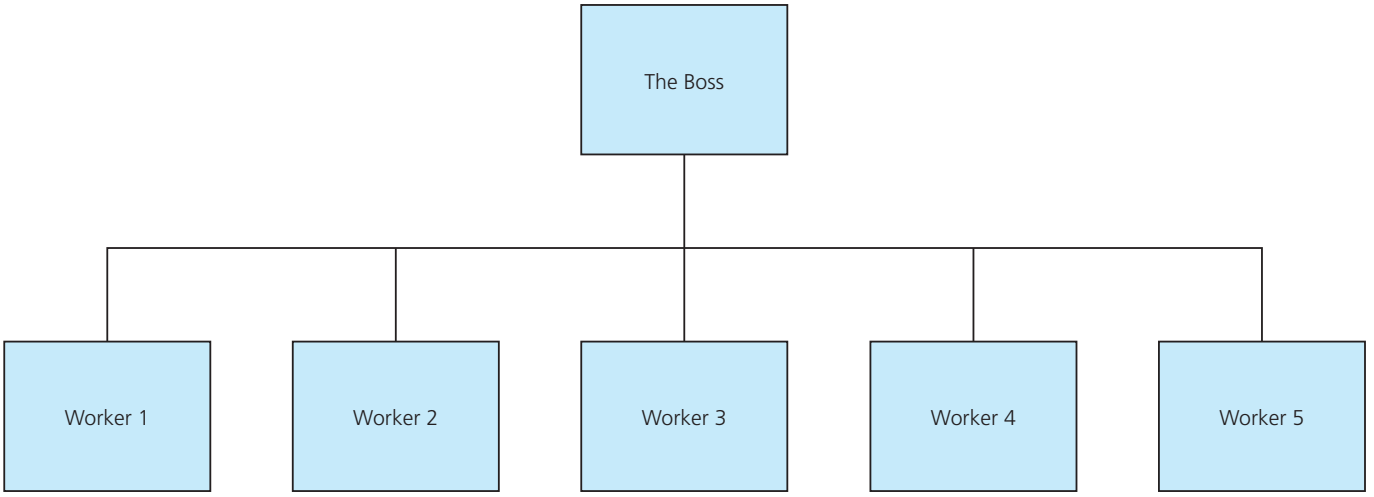


Figure 49.1 Simple organisational chart

Let's consider the structure for a large organisation like the Metropolitan Police Service. The Met has a complex command structure that reflects its wide range of activities and 45,000 staff.

The purpose of an organisation chart is to show the shape of the hierarchy and who answers to whom within the organisation. In the small firm with five employees we looked at in Figure 49.1, there were two layers in the hierarchy and each worker was answerable to 'The Boss'.

> Every company has two organisational structures: the formal one is written on the charts; the other is the everyday relationship of the men and women in the organisation.
>
> *Harold Geneen, business boss and author*

Talking point

What problems may arise if decisions take a long time to reach the workers?

Hierarchical and flat structures

Hierarchy refers to the levels of responsibility in an organisation. It is the formal structure of responsibility and authority, and is usually shown in vertical layers. The further up the hierarchy somebody is, the more important they tend to be and the more power they have. A **hierarchical organisation** is one in which individuals have relatively little room to make decisions for themselves. They have to do what the boss says.

Large organisations, like public limited companies or multinationals, have complex management structures. Such an organisation would be very hierarchical and would perhaps look like the Metropolitan Police chart shown in Figure 49.3.

The chart is like a pyramid, with the people with the most responsibility at the top. The layers form a pyramid structure as there are fewer people at the top than at the bottom. The management structure has several clear levels of responsibility. The people they are responsible for are on the next line down on the chart. This structure is called a tall structure because there are so many layers (Figure 49.2).

Advantages include:

- promotion opportunities should come up regularly; there's a clear career path
- it is easy to maintain standards across an organisation, since authority is strictly passed down the line
- it is easier to check everybody's work because there are managers and supervisors at each level.

Disadvantages include:

- people's position in the management structure shows their level of responsibility and authority; it is often seen as a status symbol with clear divisions between managers and the workers
- it is very hard for the person at the top to communicate with those at the bottom
- there can be too many layers of management, which slows down decision making.

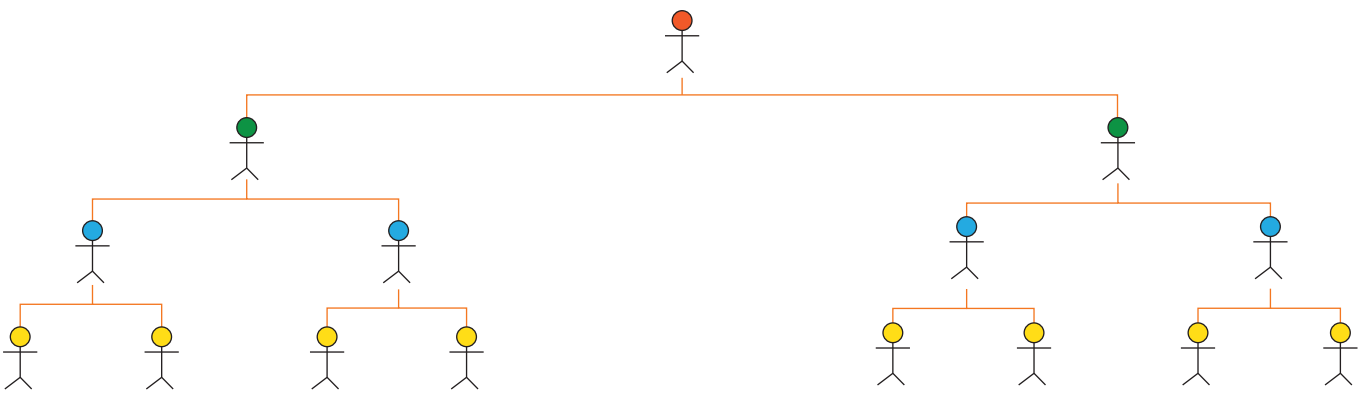


Figure 49.2 Sample organisational pyramid – tall structure

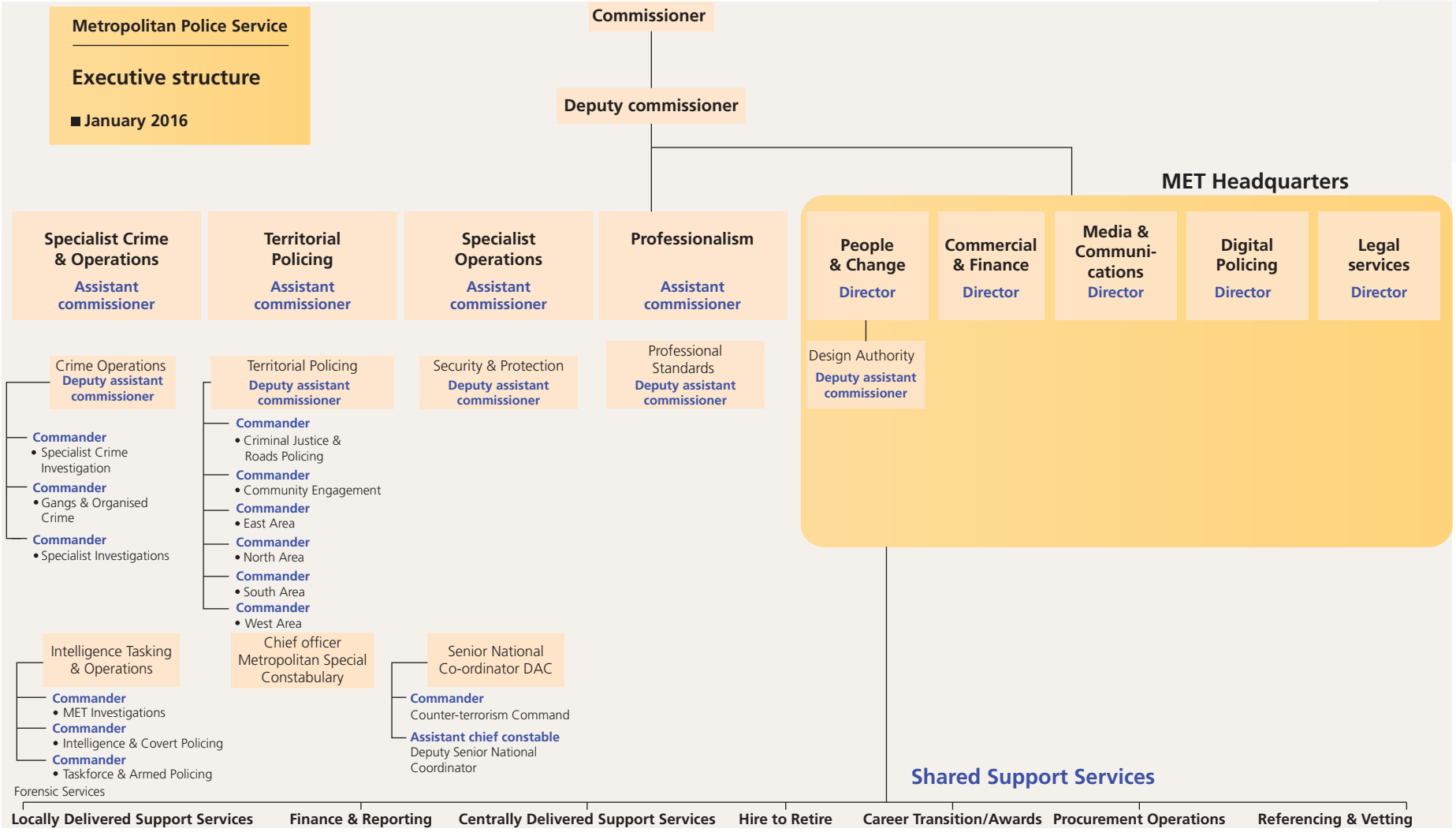


Figure 49.3 Metropolitan Police organisational chart

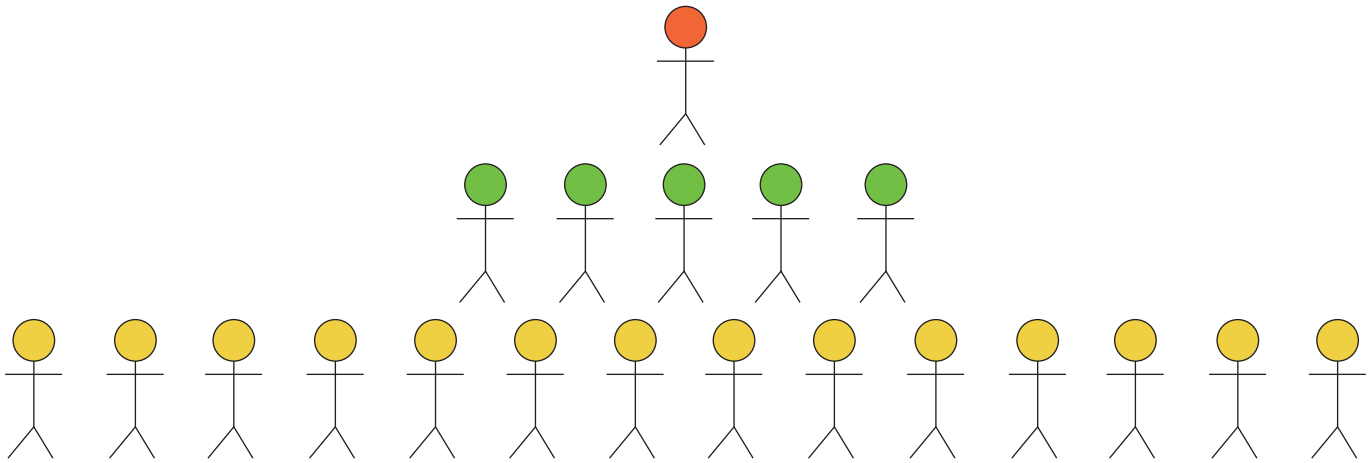


Figure 49.4 Sample organisational pyramid – flat structure

To overcome the problem of so many management layers, some businesses prefer a flatter structure, with fewer layers of management (Figure 49.4).

> In a hierarchy, every employee tends to rise to his level of incompetence.
>
> *Laurence J Peter, author of* The Peter Principle

In a **flat organisation** each manager is directly responsible for more people. People on the lower levels have more responsibility than those on the lower levels in a tall organisation. Managers therefore need to have confidence in their staff. They also need to be happy delegating work to junior staff.

Advantages include:

- fewer managers are needed, which saves money
- managers give more responsibility to the workers
- more responsibility leads to more job satisfaction for the workers
- there is faster, more efficient communication between staff and management
- it can lead to greater job satisfaction.

Disadvantages include:

- each manager is responsible for more people
- managers have to rely on junior staff much more to work efficiently and safely
- managers may lose control of subordinates as there are so many people to supervise
- it can lead to overwork and stress
- there are fewer opportunities for promotion.

Centralised and decentralised organisations

Banks such as Lloyds TSB and supermarket chains such as Sainsbury's are examples of businesses that are normally **centralised**. Local branch managers have little decision-making power: they are strictly controlled by head office and they have to follow the instructions they are given so that each branch operates in the same way. Managers are expected to send regular reports to head office. Head office will also arrange orders of supplies for all the branches; the branches have no control over finance.

Advantages of centralisation are:

- decisions can be taken with an overview of the whole company
- central managers are able to make sure that policies and decisions are followed consistently across the whole organisation
- decision making and communication can be quick.

Drawbacks of centralisation are:

- it reduces delegation; this may reduce a company's ability to respond rapidly to changes in the market, since local managers have to refer to head office for decisions
- business opportunities may be lost because people are not allowed to make any decisions
- job satisfaction may be lost as staff are not able to feel involved.

A **decentralised organisation** is one that shares out the power of decision making to more people. Important decisions are made locally, perhaps by a store manager. Head office will make the policy and still have overall control, but important decisions about the running of the branch will be made by the branch manager. For example, a Tesco Express store manager near Old Trafford might stock Manchester United programmes on match days. A decentralised approach to management encourages involvement in decisions from those further down the hierarchy.

Talking point

What might be the effect of a manager losing control of junior staff?

> Each branch is now like its own business, responsible for its own profit and loss account. This has built the confidence of the people and the branches.
>
> *David Williams, technical director at AXA UK*

Drawing the right conclusions

When companies hit problems, perhaps because of falling profits, senior managements regularly blame the organisational structure. They may decide that it is time for a change, perhaps to a more centralised system in which all significant decisions are made by the directors. This can lead to its own problems, as older, more senior staff sometimes misread the market. This is why the subject of organisational structure comes up frequently in business exam papers.

Revision essentials

Centralised organisation: an organisation in which most decisions are made at head office.

Decentralised organisation: an organisation that allows staff to make decisions at a local level.

Flat structure: an organisation with few layers of hierarchy – presumably because each manager is responsible for many staff.

Hierarchical structure: an organisation with many layers of management, therefore creating a tall organisational pyramid.

Organisation chart: a diagram that shows the internal structure of an organisation.

End of chapter exercises

1. Outline the differences between a hierarchical and a flat organisational structure.
2. Identify the benefits to a business such as WHSmith of having local managers with the power to make decisions about their local branch.
3. Explain the implications to a large firm of having too many layers in its hierarchy.
4. **(a)** Draw an organisation chart to show the structure of your school.
   (b) Give reasons to explain why the structure is designed as it is.
   (c) Evaluate the effectiveness of the school's structure.

Practice questions

2,000 staff affected by management cutbacks

A local co-op store

The Co-op is simplifying its management structure in-store. A 4-layer structure will be cut to three, with the job of team manager being lost. They are assuring staff that there will be no redundancies, but inevitably some managers will be disappointed.

The Co-op says it has trialled the new 3-tier structure and knows it can work well. The new structure comprises a store manager, a team leader per shift and a customer team leader. The management hopes it will speed up communications and decision-making, ensuring efficient and well-run shops.

All team managers will be offered the lesser job of team leader, with their current pay protected for six months. To comply with the law, it is to start a 45-day consultation period with the staff affected. Many of these have spent years working their way up the career ladder and will be upset that a rung has been taken from under their feet. But other stores such as Morrisons have already done the same thing, so Co-op may feel forced to adopt the same cost-saving measure.

Not long before it made this announcement about staffing the Co-op declared that its annual profits had doubled to £77 million. This was the time of the Covid-19 pandemic. It also announces its food sales had grown by 6.9 per cent over the last year. Given its trading success it repaid £15.5 million to the government in furlough support. It did not, however, repay £66 million it received in relief from business rates. Others such as Tesco chose to do so.

Source: Various 22 April 2021

Total: 20 marks

1 Outline one reason why the Co-op may want to cut one layer of management from its organisational structure. (2)

2 Removing one management layer from its stores will make the Co-op's organisational structure flatter. Analyse the effect this may have on the customer experience. (6)

3 Evaluate the possible effect on communication at Co-op stores as a result of reducing the management layers from four to three. (12)

50 The importance of effective communication

Imagine it is a Saturday afternoon and a group of you have gone into town shopping. You go into Frockshop and decide to try on some clothes. A couple of you try on the same style of jeans. Whichever size is tried, they come up a bit small. You have to buy a 30″ or even a 32″, even though your waist is 28″. Who wants to do that? As you leave the fitting room you mention it to the fitting room assistant.

Other customers do the same but nothing is done. Eventually the store decides to drop that range of jeans due to poor sales figures. Existing stock has to be sold at 70 per cent off, and you start to shop at Lara where the jeans fit properly!

At Frockshop, the fitting room assistants were not involved in checking the quality or monitoring sales of clothes. Their job was to ensure the fitting room was run and managed well. The story would have ended differently if the store manager at Frockshop had taken the time to meet and talk with the fitting room assistants. The manager would have discovered that the batch of jeans was wrongly sized quite quickly.

- There are lots of different ways in which people can communicate. Even so, some managers only want to 'tell' and not 'ask'. Many employees in a business know and have an interest only in what their job is within their department. A really successful business has two-way **communication** with employees on a regular basis.

The purpose of communication

Why is communication so important to the success of a business? Managers need to communicate in a business in order to do the following:

- Provide and collect information about the business: the store manager in Frockshop did not communicate properly with the shop floor workers and, therefore, a potentially profitable product line was dropped due to poor communication. Staff were not motivated to say anything. Managers will have no idea how the business is performing or what staff are doing without communicating.
- Give instructions: it is important that staff understand what jobs they have to do. Once a manager has planned how the business' aims and objectives will be achieved, the next job is to put the plans into action. All managers in all organisations need to give workers instructions as to what task they are required to do, who is to do the task and when it should be done by.
- Ensure all workers are working towards the same goal: it is very important that all workers have knowledge of what the company is aiming towards. A business might have a goal of achieving more profit. It might intend to achieve this by launching a new product. But if the research and development department and the marketing department do not know about this planned course of action, the aim will probably not be achieved.

Without managers having this knowledge, the business cannot run smoothly.

What is effective communication?

It is quite easy to communicate simple instructions – as long as people are listening. To be effective, communication depends on the motivation of the receiver. Many a student teacher has found that saying things is not enough – not even shouting them! It only works if everyone listens. So the best way to ensure good, two-way communication is to have well-motivated staff (see Chapter 54).

The best way to find out whether the communication has been effective is to get feedback. This may mean asking each person individually, or requiring a text/email response from everyone.

To be effective, communications need to be:

- clear and easily understood
- accurate
- complete
- appropriate
- via the right medium
- with a chance for feedback.

> The greatest problem in communication is the illusion that it has been accomplished.
>
> *George Bernard Shaw, Nobel prize-winning playwright*

The process of effective communication

A business needs to make sure that it has effective communication channels to allow the flow of information around it. The communication process involves a sender, for example a 14-year-old boy; a message, 'Mum, can you come and pick me up?'; an appropriate medium, a text message; a receiver, Mum; and, most importantly, an opportunity for feedback, 'What time and where do you want me to pick you up from?'

It is not safe for anyone to assume that just because a message has been sent, that it has been received and understood. Some big mistakes have been made as a result of poor communication. The infamous Charge of the Light Brigade during the Crimean War happened because the instructions of an army commander were misunderstood by his commanding officer. It resulted in the death of over 100 men.

The impact of insufficient communication

Sometimes there may be too little communication in business. Some bosses tend to shut themselves away, communicating with only a small group of trusted managers and assistants directly. They end up cut off from the day-to-day reality of staff experience.

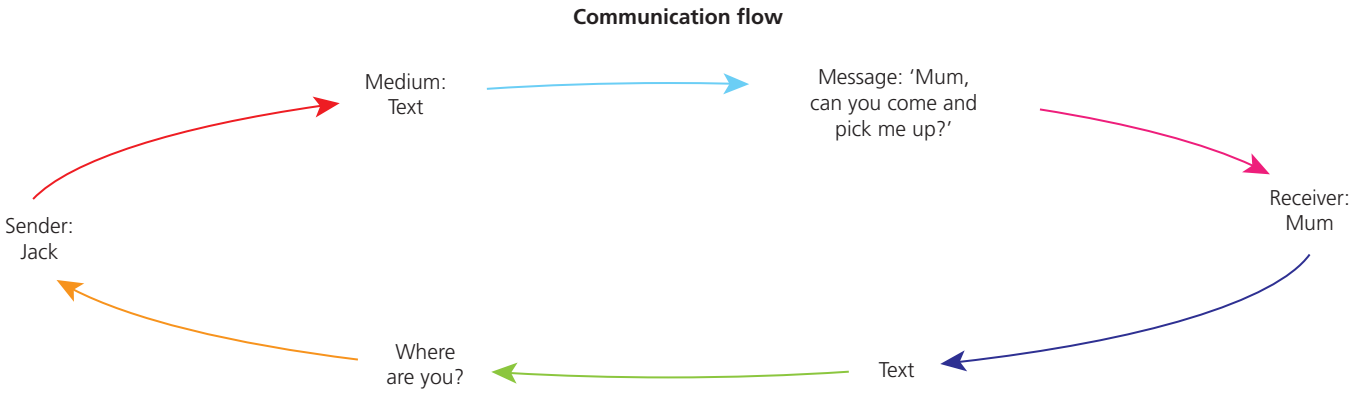


Figure 50.1 Communication model

There are some key consequences of **insufficient communication**:

- Misunderstandings and rumours: if staff are hearing little directly from the boss, the vacuum may be filled with rumours. Whispers about possible redundancies can easily turn into 'certainties' in the minds of some. This could undermine staff morale.
- Inefficiency: sometimes workers in a particular area of a business may have an idea that could improve efficiency – they may be doing a job every day and have a suggestion as to how the job could be done better. If there is no opportunity to communicate their ideas, this could cost the business money.
- Low levels of motivation: if staff feel that their ideas are not listened to, they might feel that they are unimportant and have low self-esteem, which could lead to decreasing productivity levels. If workers are constantly getting things wrong because instructions are not clear and they have no opportunity to clarify their understanding, this will lead to low motivation and perhaps high levels of staff absences.
- Profits lost: if communication within the organisation is insufficient, this is ultimately going to affect levels of customer service or sales – think of the Frockshop example, where the customers turned to Lara. This will affect profits.

The impact of excessive communication

Advances in technology today allow the same message to be sent to large numbers of people at the same time, for example using email. This could keep all the employees in a business informed of developments in the organisation. Unfortunately, there is often so much email every day that staff can become overwhelmed, or at least bored by it all. All the emails, texts, phone calls and voice mails can lead to information overload.

It is estimated that more than half of all managers struggle to deal effectively with the information they have to process. It can also mean that some people in business are working 24/7, constantly bombarded with information. To counteract this, some businesses in France ban emails after 5.30 p.m. – good for them.

Emails stop at 5.30 p.m. in some French companies

- Research shows that middle managers in businesses receive about 10,000 emails a year. If an overloaded manager misses a key message from a customer ('We ordered 4,000 blue; please change to 2,000 red and 2,000 blue') the impact is obvious. The customer is disappointed and may, perfectly reasonably, refuse to pay. The business, having delivered 4,000 blue, may have to go and pick up 2,000 blue and replace them with red. Expensive! In this case **excessive communication** hits the efficiency of the business, and would have a negative effect on the confidence and motivation of the under-fire manager.

> In industry there's too much communication, and of course it's passive ... but if people are doing idiot jobs they really don't give a damn.
>
> *Professor Fred Herzberg, motivation guru*

Barriers to effective communication

Business communication may be ineffective for a variety of reasons:

- the person sending the communication might not explain themselves properly
- the receiver of the information may not understand the message due to the technical language or 'jargon' used
- the receiver may not hear or receive the message due to a technical problem

- the message may get distorted in its transmission – especially if the message has to pass through many management layers in order to reach its target.

All these **barriers** would be overcome if there was an opportunity for feedback to clarify the message.

Talking point

How can managers make sure that they are communicating effectively?

Drawing the right conclusions

Research among managers shows that 'communicating' is the task that occupies more of their working day than any other. If they're not communicating with fellow staff, they may be communicating with customers or suppliers or contractors. So, good communication is a critical part of most successful people's skill set.

Revision essentials

Communication: the passing of information from one person or organisation to another.

Barrier to communication: something that prevents the flow of communication.

Insufficient communication: too little communication, which might leave some staff under-informed and demotivated.

Excessive communication: too much communication causing overload for staff – a particular problem with email.

End of chapter exercises

1 Use the chapter to identify three reasons why good communication is essential to any organisation.

2 Give two reasons why a business might experience barriers to effective communication.

3 Outline why it might be useful for a manager to arrange a regular meeting with staff.

4 Explain two problems that could arise as a result of poor communication between the sales department and the production department.

5 Each year the *Financial Times* carries out a survey of staff attitudes to find Europe's 'Best Workplaces'. A past winner was Microsoft. An article on why Microsoft did so well identified its communications as an exceptional strength. Below are some quotes about communications at Microsoft:

(a) 'At Microsoft employees spoke about the open communication with their leaders.'

(b) 'They [managers] share the goals and results without withholding any information.'

(c) 'Ask management any reasonable question and get a straight answer.'

(d) 'Microsoft is very transparent about its pay model and bonus plans.'

(e) 'The entire company holds a Happy Hour on the second Friday of the month ... a chance to eat and drink together.'

(f) 'Higher management is open for a talk when you need advice or feedback.'

Decide which two of these six statements are the most important ones for successful communications in a workplace. Explain why you have chosen them.

Practice questions

Talking about removals

'The key thing I learned was the importance of good communication within any company. Without good communication on a day-to-day basis it can be very difficult to provide a good service.' This was the conclusion reached by Pickfords' director Grant Whitaker after spending a week on the removal vans in Birmingham. He was trying to find out how he could make the business better. Pickfords is a nationwide moving and storage company.

All removals depend on the salespeople, who visit the customers first to price the job and see how long it will take before letting the removal team know what they think. Often the drivers arrive late to jobs and find irate customers waiting for them. There seems to be a communications barrier between staff and customers. The reason for lateness is usually due to difficulties getting furniture up and down stairs and out of the houses.

One of the drivers showed Grant a set of aluminium ladders he had found that would make lifting the furniture much easier and quicker, but head office would not listen to his idea. The drivers often feel they are kept in the dark about the business. Grant took his findings back to the board of directors for discussion.

Total: 20 marks

1 Explain the importance of good communications in businesses with large workforces. [3]

2 Outline one piece of evidence that suggests poor communications at Pickfords. [2]

3 Analyse the benefits to the business of solving these problems. [6]

4 Pickfords is considering how to improve communications between management and the workforce. It sees two options:

- Option 1: Weekly video broadcasts given by Grant Whitaker, which every staff member must watch.
- Option 2: Weekly local meetings between staff and area managers, plus monthly meetings between area managers and head office.

Justify which **one** of these two options the company should choose. [9]

51 Different ways of working

According to UK government figures, 950,000 people have a job with no guaranteed minimum hours. In effect they have a zero-hours contract. At the end of this week they may be told they have no work next week – and therefore no pay. Awful if you're living at home with your parents; terrifying if you *are* a parent, needing to feed the kids.

There are three broad categories of employment:

- full time: usually between 35 and 40 hours a week, which entitles the employee to 28 days' paid holiday leave
- part time: for example three days a week, typically the same three days each week; this system gives predictable pay and holidays
- **flexible hours**: hours/days can vary within an agreed annual total, which helps the employer without affecting the employee's overall earnings; alternatively, the flexibility can be within a zero-hours framework, giving the employee no security at all.

In addition to employment there is **self-employment**, which includes entrepreneurs starting a business they hope will one day become a giant and people who are working for themselves. Those working for themselves would be the vast majority, such as cab, minicab and Uber drivers, who work from home. There are also many people pressed to be self-employed by companies that don't want responsibilities for sick or holiday pay. Millions of cleaners, care workers and others exist on low pay within the apparently glamorous self-employed sector.

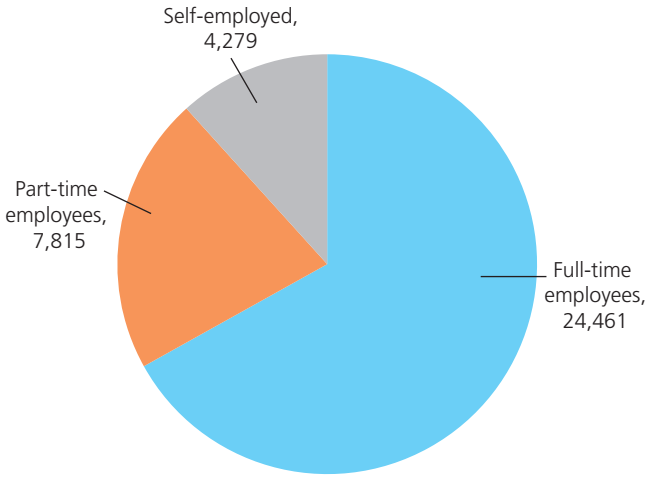


Figure 51.1 Ways of working, presented in thousands (Source: ONS, April to June 2021)

Permanent, temporary and freelance contracts

Permanent staff are employed on indefinite contracts, meaning that they are open-ended. By implication, you have a job until you retire. Such contracts can be full time or part time. The benefits of such a contract are that:

- you have stable earnings and a high degree of job security (though, of course, the company has the right to make you redundant if revenue falls or your skills are no longer needed)
- you will have regular contributions towards your pension and probably sick pay – providing still more financial security
- because you're permanent, you're worth investing in from the employer's point of view, so you'll be sent on training courses to improve your job and personal skills.

Temporary contracts offer a job for a set period of time, such as three months or a year. For an increasing number of new teachers, fresh from training, the best they can expect is a one-year contract. In the past they'd have been given a permanent job. Although most would prefer a permanent job, a temporary contract has some benefits:

- A young worker may be as keen for travel as for a career, so a one-year contract followed by a trip round the world might be perfect (but hard to finance).
- An employee with enough skills should always be in demand; it might be interesting to work in several places for a short time before looking for a permanent job.

Freelance contracts offer no guarantees beyond a single task. Whereas a temporary contract might give you 35 hours a week for three months, freelance means one job today worth £80 but perhaps no more until next week, making it very insecure. It is the world of TV actors, many journalists and photographers, and also many lower-paid workers such as bricklayers' assistants.

> TV is a fickle business. I'm only good for the length of my contract.
>
> *Tom Brokaw, legendary US TV news anchor*

The impact of technology on how we work

With fast broadband, smartphones, Teams and Zoom, it is increasingly easy to work with others while not being next to them physically. This is helpful for releasing key staff from the daily grind of commuting. Two days a week in the office and three working from home is realistic. The staff member has more flexibility for picking children up from school, but can still keep on task. Many professionals are happy working through the night to get a task completed. With this system they can have a day off when the sun's shining.

Sadly, it is not all like that. When conveyor-belt factory work took off in the early twentieth century, staff were monitored by supervisors. A trip to the toilet needed permission. Fierce protests by trade unions eventually led to workers having more control over their working lives. Now technology has turned the clock back for many. The modern equivalent of an old factory is a warehouse sending out thousands of Amazon or ASOS items to customers, but today technology is used to monitor the speed and accuracy of every aspect of the modern worker – sometimes in ten-minute segments. Trips to the toilet are recorded. Technology can be the snooper as easily as it can be the helper.

The impact of technology on efficiency

When you tap that Domino's app, it is not a drone that brings the pizza, it is a bloke on a wobbly moped with a red L-plate on the back. All the technology that goes into the app makes little difference to the efficiency of delivering your margherita. In this case, the technology has shifted business from Pizza Hut to Domino's, but not made much difference to efficiency.

In other situations technology may be very important. The London-based bicycle maker Brompton increased its output per worker from 120 bikes a year to 149 between 2011 and 2019 – a key factor was buying in automation and robotics to work alongside the skilled staff.

What the above cases prove is that technology doesn't automatically improve efficiency; every case must be looked at on its own merits.

Bicycle maker Brompton uses automation and robotics alongside skilled staff

The impact of technology on remote working

Information technology makes it possible to work at home or abroad instead of in the office, but this possibility needs to be managed with care. After all but key workers were told to work at home at the beginning of the pandemic, in April 2021 Google tried to insist that staff should return to the office, i.e. to stop **remote working**. The company was worried that the business would lose out if staff lacked the opportunity for natter and banter from which – occasionally – good ideas emerge. Some people believe Covid-19 will cause a permanent shift towards remote working. Employers such as Google may try to stop that happening.

> In teamwork, silence isn't golden, it's deadly.
>
> *Mark Sanborn, US business author*

Talking point

Would you like a job where you work entirely from home?

Drawing the right conclusions

'Flexible' is a very positive word in many ways, implying a degree of freedom, especially from a humdrum 9–5 working life. And flexibility can be wonderful – for the black cab driver who can choose to go for a midweek seaside break without telling anyone, let alone asking permission. But flexibility can also be quite crushing for someone who has to jump to a boss's 'flexible' demands. One week with no work and no income; another week with two day shifts followed by four night shifts – and perhaps young children who need transport, food and the occasional hug. Suddenly flexibility becomes a form of control for the boss – and may leave the employee feeling out of control of their life. There's a clear trend towards different ways of working – but they won't work for everyone.

Revision essentials

Flexible hours: a contract between a company and an employee that doesn't specify how many hours of work will be provided.

Freelance contract: an agreement over one job between a company and a self-employed worker.

Permanent contract: an agreement between a company and an employee that work and income will be provided constantly into the long-term future.

Remote working: working away from the office, typically from home.

Self employment: working for yourself, not a full-time boss. For example, a cartoonist who produces work for several magazines each week.

Temporary contract: an agreement between a company and an employee that work and income will be provided for a specific time period, say six months.

End of chapter exercises

1 Identify two types of people who might welcome a job based on flexible rather than full-time hours.

2 Explain the downsides of a zero-hours contract from the employee's point of view.

3 Briefly explain whether 'remote working' would work well or badly for:

(a) the goalkeeper of a football team

(b) a specialist in creating and drawing the 'people' in computer games

(c) a primary school teacher.

4 Look at Table 51.1, then answer the questions below.

(a) Outline two possible reasons why the trend towards self-employment was higher among ethnic minorities than the white majority.

(b) Explain the possible effect on the Afro-Caribbean communities of the sharp rise in self-employment.

5 Figure 51.2 shows productivity at Jaguar Land Rover in 2014 and 2019.

(a) Using the information in Figure 51.2, calculate JLR productivity in 2014 and in 2019.

(b) Outline two possible explanations for this change in productivity over time.

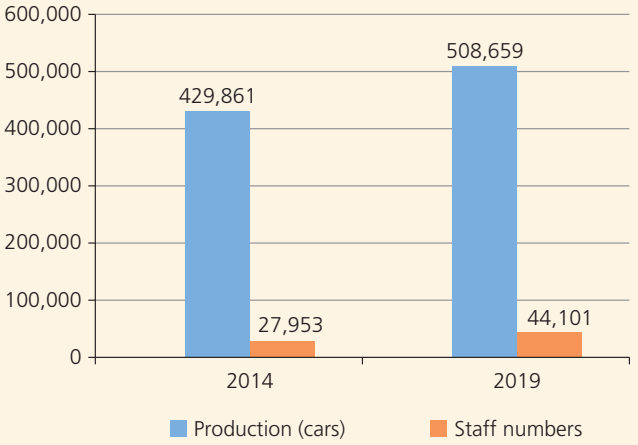


Figure 51.2 Productivity at Jaguar Land Rover in 2014 and 2019 (Source: Global data from JLR annual reports)

Table 51.1 Self-employment in the UK, broken down by ethnicity (Source: ONS UK August 2021)

	White	Ethnic minorities	Pakistani	Indian	Afro-Caribbean
2013	3,861,500	439,200	110,000	102,500	71,100
2018	4,260,000	578,900	146,300	115,500	106,800
% increase	+10.3%	+31.8%	+33.0%	+12.7%	+50.2%

Practice questions

Deliveroo riders protest against changes to pay structure

Delivery riders are rebelling against plans to pay workers £3.75 per delivery instead of an hourly rate of £7 plus £1 per delivery. Outside the Deliveroo headquarters more than 100 self-employed workers gathered calling for the company to keep the hourly rate. Riders said they often earned less than the 'national living wage' (currently £7.20 an hour) once their expenses were taken into account.

Fahran, who delivers for the firm on his motorcycle, said removing the hourly rate would cause him to struggle. 'My phone contract is the same, insurance is the same – everything else is fixed,' he said. 'I have two children and I need to pay for them. They are forcing people to take benefits.'

Deliveroo riders are considered self-employed, even though their working life is controlled by the app that gives them orders from the company. This gives them freedom over their working hours, but deprives them of the regular salary beloved of building societies and other lenders to those wanting to buy their first property. The £7 hourly rate was the guarantee of a minimum income. That was what the riders were insisting on.

Deliveroo's founder, Will Shu, wanted an even more flexible payment system to maximise the value of the business at flotation, i.e. when looking for outside stock market investors. This point eventually came in 2021, with drivers paid more per delivery and less per hour. This helped Deliveroo float on the London market for an astonishing £7.6 billion. Whether or not the riders were doing well financially, Will Shu certainly was.

Total: 16 marks

1 Define the term 'flotation'. (1)

2 Outline one reason why the delivery riders disliked the new Deliveroo deal. (2)

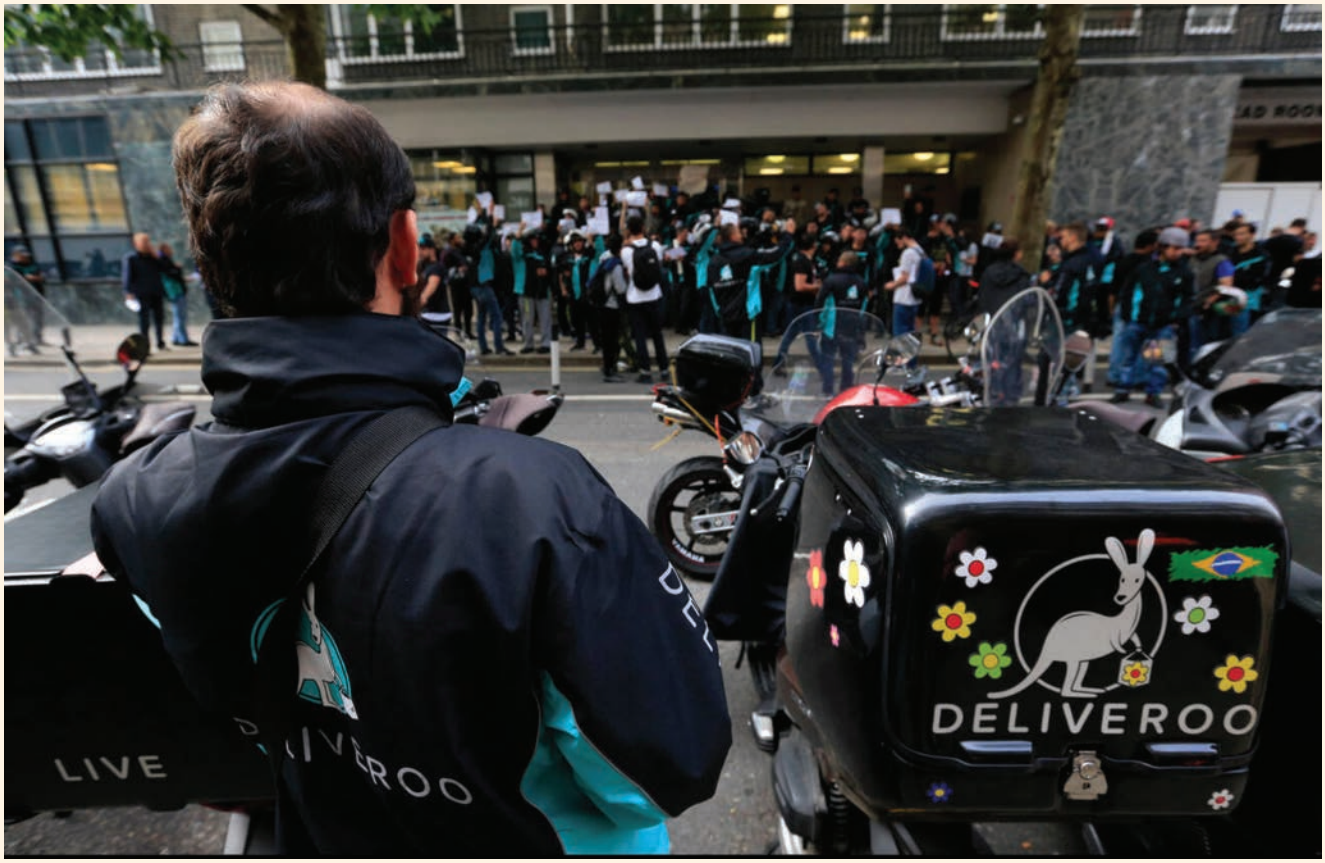
3 If Will Shu owned 10 per cent of the shares in Deliveroo, calculate the value of his shares at the time of the flotation (2)

4 Outline one benefit to the business of using self-employed riders instead of employing them permanently (2)

5 Deliveroo is considering how to avoid such bad publicity in future. It sees two options:

- Option 1: Arrange weekly meetings with an elected representative of the delivery riders.
- Option 2: Tell the riders that they must sign zero-hours contracts instead of being self-employed from now on.

Justify which **one** of these two options the company should choose. (9)



Deliveroo's self-employed workers gather outside the company's headquarters

52 Effective recruitment

Salvatore Falcone has run a bakery in Wimbledon for over 50 years. In that time he has built Panetteria Italiana into a terrific business. People drive 20 miles to buy armfuls of bread for their freezer. His Saturday morning queue is legendary. Yet in all these years he has rarely been able to find and keep staff. His business works because his wife and three children work there. When he tries to recruit someone, he usually finds the person too slow or too unconcerned to be worth having. He says, 'I take them on, I spend weeks training them up, then they decide to go elsewhere.'

For a small firm, recruiting staff is a worrying process. There is a huge amount that could go wrong. And a small business lacks the expertise to avoid some of the pitfalls. Is the job interview process unbiased? And does the person being interviewed really want the job, or are they just planning to use it as a stepping stone to something better?

For a large business, recruitment is an inevitable part of every week. Tesco employs 367,000 people worldwide and has to recruit around 900 staff every week. The recruitment method varies depending on the seniority of the job role. The next section considers job roles and responsibilities.

> The key for us, number one, has always been hiring very smart people.
>
> *Bill Gates, founder of Microsoft*

Key job roles and responsibilities

The following are key jobs that you might find in a big company.

Directors

Directors are members of 'the board', that is, the board of directors. They handle the most senior appointments, set out the main aims and objectives of the business, and discuss the key decisions faced by the business. Some board directors are executives working within the business, such as the marketing director. Others are outsiders, recruited to the board for their independent expertise; for example, a medium-sized clothes retailer might recruit a retired, former-director of Primark.

An interview enables the employer to judge the applicant's personality and attitude

Senior managers

A manager is a person responsible for organising others to carry out tasks. A senior manager will be involved in deciding what needs to be done, then finding the right middle manager to get the job done.

Senior managers need to communicate well with each other. For example, the head of marketing might discuss quality issues with the head of operations and the head of human resources.

Supervisors/team leaders

This junior management role is largely to do with ensuring that shop-floor staff do exactly what is asked of them. Do the checkout staff remember to greet each customer? Are there bare shelves in the store and, if so, why? Good team leaders make shop-floor staff want to meet the high standards asked of them.

Operational and support staff

Another important business issue is whether a job role is operational or support. An operational executive has direct responsibility for achieving a specific target, for example that sales will be up by at least four per cent on last year. The executive may get a bonus if the target is reached, but worry about their career prospects if it isn't. Support staff have no such pressures. They are employed to help the operational staff but don't have direct responsibility for achieving targets. The marketing director is held responsible for sales; the market research manager isn't.

> Hiring and training are costly – but it's infinitely more costly to have a barely average man on the company payroll for 30 years.
>
> *Gordon Wheeling, personnel manager*

How businesses recruit people

There are more than 5 million businesses in Britain, but fewer than 1.5 million have any employees. The vast majority are true sole traders: a business run by one person, perhaps helped by family members.

The star businesses are those that break away from being purely family firms. They need the courage to hire staff, despite the problems that may result. Every staff member causes a business to pay extra taxes, give four weeks' holiday pay and meet laws that cover health and safety, job security and conditions of work.

The breakthrough comes when employers gain the commitment and confidence to hire people and start treating them like adults. This requires skills that many entrepreneurs lack. They are often good at bossing people about, but poor at encouraging people to think for themselves.

Often small firms start by recruiting friends or former workmates. This gets round any concerns about whether the new recruit will prove unfriendly or work-shy. As a business grows, however, the boss will soon run out of friends to be brought in. Then the real process of judging people that you do not know begins. The keys to this process are:

- an **application form**, written well enough to provide useful, checkable information about the applicant, but not so detailed as to put potential applicants off
- a **CV (curriculum vitae)**, which sets out the person's qualifications, experience and any other relevant facts
- **references**, usually in the form of a letter from a named teacher or former boss, who will write about the applicant's qualities, strengths and weaknesses.

For bigger businesses, the recruitment process tends to start with two documents: the job description and the person specification.

> Hire character. Train skill.
>
> *Peter Schutz, former head of Porsche*

Job description and person specification

The recruitment process may be triggered by an existing employee finding a better-paid job elsewhere. Alternatively, additional workers may need to be recruited in order to support a firm's expansion strategies. Once the firm has established its requirements, the next step is to draw up a job description and a person specification.

A **job description** relates directly to the position itself, rather than the person required to fill it. Typically, a job description would contain the following information:

- the job title
- the main duties and tasks involved
- the person to whom the job holder reports and any employees for whom the job holder is responsible.

A **person specification** identifies the abilities, qualifications and qualities required of the job holder in order to carry out the job successfully. The main features of a person specification include:

- any educational or professional qualifications required
- necessary skills or experience
- suitable personality or character, for example the ability to work under pressure or as part of a team.

Internal and external recruitment

A business may choose to fill a vacancy internally, that is, from the existing workforce. This could be done either by redeploying a worker from elsewhere in the business or promoting someone. Although **internal recruitment** can have a number of benefits, it also has a number of disadvantages. It is of little use when a business needs to expand its workforce in order to respond to an increase in demand.

External recruitment means hiring someone from outside the business. This is likely to be more expensive than internal recruitment, as it will require one of the following approaches:

- media advertising: buying job ads in newspapers or specialist magazines, on the radio, TV, or by using dedicated employment websites such as www.monster.co.uk
- job centres: government-run organisations that tend to focus on vacancies for skilled and semi-skilled manual and administrative jobs
- commercial recruitment agencies, such as Alfred Marks or Reed, which recruit staff of all types in return for a (substantial) fee
- websites: in addition, many businesses have careers pages on their own websites, which are used to advertise vacancies.

Table 52.1 Advantages and disadvantages of internal recruitment

Advantages	Disadvantages
It is likely to be quicker and cheaper than external recruitment Greater variety of promotion opportunities may motivate employees The firm will already be aware of the employee's skills and attitude to work	Existing workers may not have the skills required, especially if the business wants to develop new products or markets Relying on existing employees may lead to a stagnation of ideas and approaches within the business Recruiting internally will create a vacancy elsewhere

Table 52.2 Advantages and disadvantages of external recruitment

Advantages	Disadvantages
It should result in a wider range of candidates than internal recruitment Candidates may already have the skills required to carry out the job in question, avoiding the need for (and cost of) training	It can be an expensive and time-consuming process, using up valuable resources It can have a demotivating effect on members of the existing workforce, who may have missed out on promotion

Drawing the right conclusions

Firms that aim to grow have no choice but to recruit staff, and it usually proves to be much harder than anyone expects. For small businesses, poor recruitment becomes a serious drag on the ability to develop and grow. In bigger businesses recruitment becomes a constant process, which in itself can help build a degree of expertise.

Perhaps the best approach is to always see internal recruitment as the priority. That gives a consistent message to staff that you trust them and want to give them every opportunity to succeed. At the time of writing (August 2021), Marks & Spencer is headed by Steve Rowe, who began working for the company aged 16. He worked his way up from the bottom to the top of the organisation through a series of internal promotions. What a wonderful way to encourage every M&S employee.

Revision essentials

Application form: the series of questions a job-seeker must fill in when trying to get an employer interested in interviewing them.

CV (curriculum vitae): sets out the person's qualifications, experience and any other relevant facts (it literally means the 'story of life').

External recruitment: appointing from outside the existing staff.

Internal recruitment: appointing from within the existing staff.

Job description: a short account of the main features of the job.

Person specification: a description of the type of person who would best fit the job: their character, experience and skills.

References: people such as teachers or previous bosses who are willing to answer questions about the qualities of a job applicant.

End of chapter exercises

1 Outline three reasons why a small business may need to take on additional staff.

2 Suggest two reasons why the owner of a small business might be reluctant to employ more staff.

3 Examine two advantages of recruiting part-time staff to a small, expanding business.

4 Suggest one suitable method of dealing with the following staff shortages:

(a) providing cover for a receptionist on two weeks' holiday

(b) providing extra sales assistance at a delicatessen on Saturdays

(c) providing additional waiters and kitchen staff at a restaurant over the busy Christmas period.

5 In 2021 a nationwide shortage of heavy goods vehicle (HGV) drivers threatened to halt recovery from Covid-19. Many drivers had returned to Europe when Brexit finally occurred at the end of 2020. Tight new immigration rules stopped them from returning, so supermarkets and other employers had to try hard to recruit the few qualified drivers.

Read the following extract and answer questions (a) and (b).

Join before 30 September 2021 to receive a bonus of £1,000.

As a Tesco HGV Driver you are the face of your Distribution Centre and an ambassador on our roads. You'll play a vital role for our customers and communities, representing Tesco on the highways and byways of the UK. We're looking for people to be our driving force, who love what they do and take pride in what they do. For all our latest roles please see below or alternatively please click the above 'Search and Apply' button for all of our HGV Driver roles across the UK.

Source: Tesco website, 30 August 2021

(a) How else might Tesco have approached its recruitment problem, besides offering a £1,000 bonus?

(b) Where possible, companies should plan ahead rather than be caught out by a staff shortage. How might they do this?

6 Tim and Nattasja are setting up an extreme sports travel agency in London. They're aiming at young adults wealthy enough to spend £1,500– £3,000 on a holiday based on skydiving, mountaineering or jungle trekking. They need to recruit three staff to work in the front office, selling directly to customers.

Which two of the following factors would be the most important when choosing who to recruit for these jobs?

(a) A warm, outgoing personality.

(b) A very well-presented CV.

(c) Enthusiasm for unusual, tailor-made holidays such as these.

(d) Some understanding of travel industry computer-booking systems.

(e) Their GCSE and A level results.

Practice questions

Graduate Leadership Development Programme (I.T.)

To be considered for this programme you will demonstrate a high level of energy in pursuing work objectives and a total commitment to achieving successful outcomes, as shown by your academic results and extra-curricular activities. You will have long-term ambitions with first class communication, planning and organisational skills.

We are looking to take on graduates who will develop into the company's leaders of the future. On joining Raytheon, you will undertake a structured two-year leadership development programme. You will be given a real job from day one and will be expected to start adding value immediately.

By joining Raytheon you will have the opportunity to work within a range of different areas of the IT function. Enthusiasm for a career in an innovative organisation is essential, as is the ambition to succeed.

Candidate requirements – Essential:

- You will have achieved (or be expected to achieve) at least a 2:1 in any IT, Business/ Project Management, Engineering, Maths, Physics or Humanities-related degree discipline.
- A-levels (or equivalent) with a minimum of 300 UCAS points.
- Be a logical thinker with excellent problem solving ability.
- Have strong communication and presentation skills.
- Be methodical, hardworking, enthusiastic and able to work well under pressure.
- Self-motivated, energy and drive.
- Team player.

Raytheon career development:

Raytheon has a wealth of resources available to help you develop your career from the moment you join. Activities range from online learning modules, to external training and support for taking professional qualifications relevant to your role.

About Raytheon:

Raytheon UK is a subsidiary of Raytheon Company. Raytheon Company, with 2019 sales of $29 billion and 70,000 employees, is a technology and innovation leader specialising in defence, civil government and cybersecurity solutions.

Standard benefits:

- £1,500 joining bonus.
- 25 days' holiday plus statutory holidays.
- Contributory pension scheme, life assurance, flexible benefits and enhanced sick pay scheme.

Diversity:

Diversity is a core business imperative at Raytheon. We are an equal opportunity employer that promotes inclusiveness and always employs the best professionals for the job. Having a diverse workforce allows Raytheon to draw upon a range of different ideas and experiences, which supports growing our business and creates an environment where everyone has an equal opportunity for success.

Source: Adapted from www.milkround.com

Total: 15 marks

1 Analyse whether a job description and a person specification would be enough to ensure that Raytheon recruits the right person for this job. (6)

2 The management at Raytheon is considering who best to recruit for this job:

- Option 1: A brilliant university student, predicted to get a first class degree, who started up and is now captain of the Oxford Football Club's women's team.
- Option 2: A graduate with a 2:1 degree who has spent the last year volunteering in Africa. She has been running a team designing and building a road bridge over a small river in Namibia.

Justify which **one** of these two options Raytheon should choose. (9)

53 Effective training and development

For many years productivity in the UK has been 25–30 per cent lower than in Germany. In other words, we take 25–30 per cent longer to complete a task than people working in Germany: building a wall, perhaps, or fitting doors to new cars. The reason for this is no mystery: German workers have higher skills because of better training. Most workers have been through an apprenticeship that lasts two to three years and gives solid grounding in details like how to mix cement perfectly for successful bricklaying. German workers not only start with better skills, their companies also invest more in ongoing training for staff. It seems time for UK firms to copy this approach.

Different ways of training and developing employees

Here are some of the ways that employers can train and develop their employees.

Formal and informal training

Most trainee teachers go through a full programme of university-based sessions and formally measured teaching practice spells at schools. Most think this **formal training** programme is good, but often mention that the best bit of advice they received was in the staff room or pub from a random fellow-teacher. This would be classed as **informal training**, as would be the informal coaching that comes from a caring supervisor who just chips in occasional advice.

> Starbucks is not an advertiser; people think we are a great marketing company, but in fact we spend very little money on marketing and more money on training our people than advertising.
>
> *Howard Schulz, CEO of Starbucks*

Table 53.1 The benefits and costs to companies of providing training

Benefits of training	Costs of training
Increases the level and range of skills available to the business, leading to improvements in efficiency and quality	It can be expensive, both in hours spent providing the training and the cost of sending staff to outside courses
Increases the range of skills within a workforce, allowing it to respond quickly to changes in technology or demand	Production may be disrupted while training is taking place, leading to lost output
Can lead to a more motivated workforce by creating opportunities for development and promotion	Newly trained workers may be persuaded to leave and take up new jobs elsewhere (known as poaching), meaning the benefits of training are enjoyed by other businesses

Self-learning

There is no better way to learn than to push yourself. The most important part of **self-learning** is to learn from your mistakes. If you're not making mistakes, you're not trying hard enough; if you are making them, the key thing is to ask:

- What went wrong?
- Why did it go wrong?
- What could I have done differently?
- How should I avoid making that same mistake again?

> Insanity is doing the same thing over and over again but expecting a different result.
>
> *Usually attributed to Albert Einstein, all-round genius*

Ongoing training for all employees

When young people apply for a job they may be promised plenty of training in the early months, but what about the long-term future? According to recent research, the average UK worker has £1,500 a year spent on training them, and as many as a third of staff receive no **ongoing training** at all. The UK's output per person is as much as 30 per cent lower than the USA or Germany; this lack of efficiency could reasonably be blamed on insufficient training. In industries where technological progress is especially high, training seems essential.

Training is important to workers

Because it was worried about inadequate training from private companies, the government launched a new scheme. From 2017, every business with a pay bill of £3 million or more must pay one per cent of their pay bill to the government. Companies can apply to get the money back if they invest in an apprenticeship scheme. In effect that makes it free for companies to spend on apprenticeships. Unfortunately, by 2021 this Apprenticeship Levy had led to fewer apprenticeship places in the UK, not more. The government had the right target, but the wrong policy.

> Education is that whole system of human training within and without the school house walls, which moulds and develops men.
>
> *W.E.B. Du Bois, nineteenth-century civil rights activist*

Training is a way to keep people on top of a job

Use of target-setting and performance reviews

An ideal world might see staff organising their own careers. They might set themselves targets, arrange the training they need to help reach the target, then discuss personal progress in a **performance review** held by the operational manager. Many is the teacher who has asked a student to 'take control' of their own

education. The same line is relevant at work, where managers want staff to set targets and find a way to achieve them.

While **target setting** is an important way to agree challenging goals for the coming year, performance reviews are an opportunity to discuss achievements. Part of the process is also to consider what future training needs the individual may have.

Human resource departments love setting up targets and performance reviews. They are a sign that something is happening to encourage staff development. However, most research shows that the most important thing is day-to-day contact between supervisor and employee. In other words, regular informal chats count for much more than six-monthly performance reviews. Supervisors who take the time to talk to their staff regularly could be termed **mentors**.

> The delicate balance of mentoring someone is not creating them in your own image, but giving them the opportunity to create themselves.
>
> *Steven Spielberg, Hollywood film director*

Why businesses train and develop employees

If a job was so simple that it required no training, it probably could – and would – be done by a robot. Yet there is much more to training than telling people how to do a job. Well-run organisations keep investing in staff training because there is no limit to the amount to be learned. Take, for example, the reasons why experienced teachers might need training:

- to know about a new GCSE course, or a change to an existing one
- to be kept up to date about the latest thinking in how the exams are to be set and marked
- to learn about new technology available for teaching, perhaps via an app.

In other words, things change, and training is a way to keep people on top of their job. This should ensure high-quality staff performance and also helps staff feel properly looked after by the business, which in turn helps with motivation and staff **retention**.

The link between training and motivation is partly psychological ('they're spending money sending me on a course, so they like me') and partly practical. Motivation expert Professor Herzberg once said 'the more a person can do, the more you can motivate them'. In other words, we work more enthusiastically at the things we're good at. So, the employee trained in quality management is more likely to think about how to improve the standard of the goods produced.

If motivation can be boosted by more and better training, so too can labour retention. If an employee feels they're developing at work, they are far more likely to stay. There may be an employer down the road offering an extra 50p an hour, but the motivated staff member ignores that. They want to keep developing in the job they have.

This can create a hugely upward spiral for the business: good training boosting motivation, which boosts retention, which helps keep quality and efficiency high, which provides extra profit to pay for still more training. Welcome to Jaguar Land Rover. Such a fast-growing, prestigious employer offers status but also a rising number of promotion possibilities. Figure 53.1 shows the growth in staff numbers internationally. Jaguar Land Rover's labour retention is one of the highest in the country, at around 95 per cent. Once hired, staff want to stay.

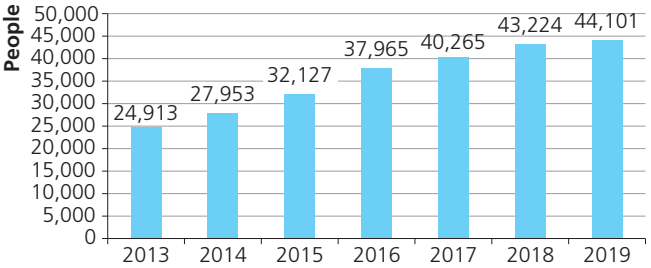


Figure 53.1 Jaguar Land Rover worldwide job growth (Source: JLR's annual reports)

Talking point

Jaguar Land Rover's success shows the benefits of investing in skills training. Consider why other UK businesses are less willing to spend money training their staff.

Drawing the right conclusions

Training and developing employees could be seen by businesses as a moral duty. This has tended to be true in Germany, where many big businesses are family owned and take a broader view of their responsibilities. Many UK firms see training as a cost that must be tested like any other cost: 'Is it value for money?' In this scenario, training is only worthwhile if it pays for itself (in better-quality output or in higher sales). Many organisations continue to view training as an avoidable expense; they cut training budgets when under pressure to cut costs or poach employees already equipped with the necessary skills from other firms. New employees can bring a number of benefits, including fresh ideas and approaches to work. However, such an approach fails to capture the long-term impact of training on labour retention, and the quality and motivation of the workforce.

Revision essentials

Formal training: the official training programme put on by the company, for example a two-year graduate training programme.

Informal training: learning on the job, usually through advice and tips from colleagues.

Mentor: someone in the workplace who gives you advice and help, officially or unofficially.

Ongoing training: regular, perhaps weekly, training sessions for all staff.

Performance reviews: discussion sessions between the employee and their boss (perhaps every six months) about how well the employee is doing against the targets set for them.

Retention: a calculation of how many staff stay loyal rather than leaving, for example staff staying as a percentage of all staff.

Self-learning: teaching yourself, perhaps by thinking why a problem occurred and making sure you learn from your mistakes.

Target-setting: when you are set goals by a manager and your job is to achieve them.

End of chapter exercises

1 Explain why informal training might be important to the development of someone starting their first job.

2 A small business owner has £40,000 of profit to reinvest in the business and is debating whether to invest this sum in new, faster computers or in staff training. Suggest two arguments in favour of each of the two options.

3 'Staff training is a waste of time as half my staff leave within a year.' Explain to this business owner why they should change this attitude to training.

4 Explain why a big business such as Google might provide a better formal training programme to new staff than a small business.

5 Training can help build knowledge, perhaps of new technologies, and help develop new personal qualities, such as self-confidence. Which of these two might be more important to:

(a) a business such as Tesco

(b) individual employees?

Briefly explain your thinking.

Practice questions

Skills shortages

By August 2021, the bosses of Tesco and Iceland were questioning whether they would have fully stocked stores for Christmas. A severe shortage of lorry drivers meant deliveries were not getting through. The shortage of drivers was due partly to Brexit and partly to Covid-19, and also because the haulage companies had allowed their workforce to age (average age 56), leading to an uncomfortably high number of retirements.

Although haulage firms and supermarket chains started offering cash incentives to train for an HGV licence, the problem remained. Being a long-distance HGV driver is a lifestyle choice rather than just a job. It results from gentle persuasion over a period of time, rather than a sudden decision.

As shown in Figure 53.2, the problem was already known to firms. This research was carried out just before Covid-19 struck, but showed that firms knew skills shortages were widespread. Why do firms wait for problems to hit instead of training staff to avoid skills shortages?

Total: 20 marks

1 Outline why cost-cutting might *not* be a priority for a manufacturing firm [2]

2 Analyse why it would be important for a manufacturing business to 'manage an ageing workforce'. [6]

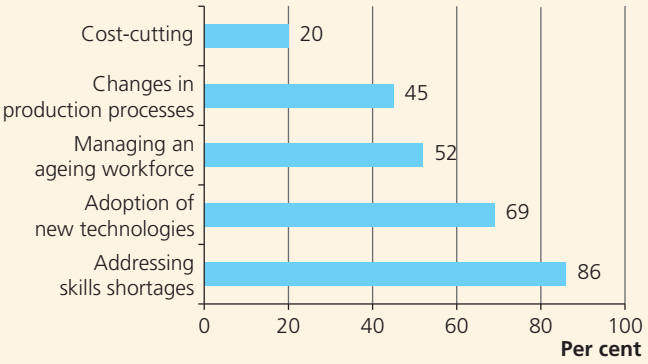


Figure 53.2 Priorities for UK manufacturing firms (Source: Modern Manufacturing Workplaces survey)

3 Explain how a business might address skills shortages. [3]

4 Tesco desperately needs HGV drivers. It sees two options:

- Option 1: Offer a £1,000 signing-on bonus, to persuade current Sainsbury's and Asda drivers to switch to Tesco.
- Option 2: Accept a chaotic six months while carefully recruiting, paying and training staff to become future Tesco HGV drivers.

Justify which **one** of these options Tesco should choose. [9]

Practice questions

Leadership training

Research by the Federation of Small Businesses (FSB) showed that just 25 per cent of small business owners invest in leadership training, with cost being cited as the biggest barrier to making such an investment. The survey also found that less than one-fifth of small business owners send their staff on external management development courses, even though 64 per cent think a lack of skills impedes business growth.

The cost of management training was the most important factor preventing business owners from providing it, with 43 per cent citing this as a key challenge. The availability of relevant training was also seen as an issue by a third of respondents.

FSB policy director Mike Cherry said: 'The UK's 5.4 million small businesses boast some of the most dynamic and creative business leaders in the world. However, our research demonstrates how greater investment in management skills could significantly benefit start-ups and scale-ups (businesses attempting to grow) and help owners realise their growth ambitions.'

Source: businessadvice.co.uk

Total: 15 marks

1 Analyse why greater investment in management skills might 'benefit start-ups and scale-ups'. (6)

2 You have been appointed as the new boss of the FSB. You are looking at two ways to persuade more small companies to invest in leadership training:

- Option 1: Ask the potential leaders who are to receive this training to contribute half the cost.
- Option 2: Ask all FSB members to contribute two per cent of sales revenue then hand out the cash to those applying to do the course.

Justify which **one** of these two options you should choose. (9)

54 Motivation

Motivation matters. Motivation matters massively. On 21 June 2021, Denmark played Russia in the group stage of the 'Euros' football championships. It was the international equivalent of Macclesfield v Barcelona. Denmark's population of 5.8 million is a twenty-fifth of Russia's 144.4 million. A week before, Denmark's best player, Christian Eriksen, suffered a cardiac arrest in the match against Finland. Now, with their supporters and the players fired up to 'do it for Christian', Denmark crushed Russia 4–1.

Motivation allows small companies to outperform large ones, and employees of average ability to outperform cleverer ones.

At 3.30 a.m. on a Saturday morning, 76-year-old Salvatore Falcone starts work at his bakery. He makes and bakes bread, pizzas, doughnuts, cakes and pastries until 11.30 a.m., then serves customers until 4.30 p.m. On a Sunday evening he races stock cars at race tracks across the South East. In return for his amazing motivation, he has been able to afford houses in London and Italy, and is now eyeing a soft-top Ferrari Testarossa.

Entrepreneurs have motivation, but the big question is how to motivate staff who are not getting the direct financial reward from the success of the business.

What is 'motivation' exactly?

To most people, motivation simply means having the commitment to do something. Within the home, it may be decorating the bathroom; at work, it may be working late to finish a job. However, Professor Herzberg says that motivation is doing something because you *want* to do it. In other words, motivation is not about whether you do it, it is why and how you do it. Motivation, he says, does not come from money or from threats – 'do this, or else' – it only comes from within.

There are many possible ways to motivate staff:

- Give them a real sense of purpose. Staff on a hospital maternity ward should be fine, but in a profit-making business it may be harder. High-quality standards can motivate people, as can success. Employees of Jaguar Land Rover have loved seeing their company's success since the dark days under previous owner Ford.
- Involve them in the decisions made by the business, for example getting shop-floor staff involved in deciding how to rearrange the shop to encourage higher sales.
- Give them meaningful, challenging tasks. A US TV station asked its staff to come up with a new schedule of programmes for a Friday night; the management followed the advice of staff and the viewing audience rose by 20 per cent. The staff then reorganised the rest of the week's programmes with equal success – and the number of staff days off 'sick' fell by 30 per cent.

The importance of motivation in the workplace

Word of mouth matters everywhere. If staff enjoy working at the Warwick Zara but not at JD Sports, word will spread. Staff will rarely leave Zara but, when they do, the best and brightest locally will apply for the jobs. The talented Zara store manager will find the job increasingly easy because of the

quality and self-motivation of the staff. The warm, positive atmosphere at Zara makes customers keen to come, stay and buy. The high motivation feeds directly through to higher sales and profits.

So, staff motivation is important for attracting employees, most notably attracting high-quality employees. Due to its rapid growth, each year Google employs 5,000 new staff. It has to select them from 2 million applicants! Although some applications can be rejected quickly, an amazing amount are very high quality indeed. And, of course, that's the point. A business as dependent on motivated brains as Google is needs to hire more motivated brains – the bigger the better.

Staff motivation is also important for retaining employees, that is, keeping them. Between 2009 and 2020 Google's worldwide workforce grew from 6,000 to 135,000. It is no good spending big on recruitment if the staff flowing in are balanced by lots of others pouring down the plughole. Keeping good staff is at least as important as recruiting them. The more motivated they are towards your company's goals and towards the job they do, the fewer will leave. That saves you:

- the cost of hiring new staff
- the cost of training new staff
- the lost efficiency – that is, productivity – in the time until the new staff have learned to do their jobs properly.

The important thing about productivity is that it relates to labour cost per unit. If a wedding dress business employs four people to make 32 dresses a month, that's an output per person (productivity rate) of 32 / 4 = 8 dresses per person per month. If the workers earn an average of £1,600 a month, the labour cost per unit is £1,600 / 8 = £200 per dress. If the business could boost productivity to 10 dresses per worker, the labour cost per dress would fall to £1,600 / 10 = £160. So the higher the rate of productivity, the lower the labour cost per unit. This would make the business more profitable, perhaps encouraging the dressmakers to ask for a pay rise.

The important thing to remember, though, is that:

- high productivity means high efficiency
- the higher the productivity, the lower the labour cost per unit
- lower labour costs per unit should mean higher profits per unit.

> Motivation is the art of getting people to do what you want them to do because they want to do it.
>
> *Dwight D. Eisenhower, former US president*

How businesses motivate employees

Professor Herzberg's view is simple: motivation comes from within. Financial methods such as bonuses are nothing to do with motivation; they are ways to incentivise. In other words, a bonus may make you do something; it doesn't mean that you *want* to do it. Denmark's football team beat Russia because they had the fire from within: that's motivation.

The following financial methods can be used to incentivise staff.

Remuneration

Most people in the UK have full-time, permanent jobs for which they are paid a salary. In other words, their monthly pay is unrelated to their efforts or achievements. Your teacher receives the same pay in August (while swimming up to that pool bar) as they do in May (when sweating over last-minute GCSE revision). Salaries work on the assumption that pay is not there to motivate or even incentivise. It is there to keep the worker happy enough to keep doing the job with no reason to click through the job advertisements.

Employees in the private sector may benefit further from **fringe benefits** – non-monetary rewards given to staff. Often known as 'perks', these are benefits other than money, paid in addition to wages or salaries. Examples include a company car, health insurance, payments into a pension fund, free life assurance, discounts when buying the firm's goods, use of a company mobile phone, subsidised

canteen and leisure facilities. These are all part of an employee's **remuneration**.

In addition to being paid by salary, many people are paid in relation to their specific efforts, be it by the hour (this week you've done 14 hours at £9.20, so it is £128.80) or in relation to the amount of work done (you've made 400 units at £1.10 a unit, so it is £440 for the week). The problem with variable incomes such as these is that mortgage payments or the electricity direct debit are constant sums. For some people, a few bad weeks of earning can put them in financial difficulties.

A company car can reinforce the status of a manager

Bonuses

Bonuses are extra payments over and above the basic wage or salary. They are often paid as a reward for reaching a target. In 2020, Sports Direct introduced a staff bonus scheme that can be worth as much as £100 million a year. The most outstanding 1,000 staff can earn bonuses of up to £1 million. Others within the workforce of 30,000 will get up to four weeks' pay as an annual bonus. The company suggests that this bonus is an important incentive to work hard and adds to teamwork within the business. But the bonuses won't be open to the many warehouse staff who are 'agency' workers, i.e. not employed directly by Sports Direct. How will they feel if their hard work gives their manager a fat bonus?

Commission

Sales people may be paid a basic salary plus a **commission** (a percentage of the value of sales).

A&M Carpet and Bed Centre is a shop based in Wigan. Peter is the director of the business and is in charge of the day-to-day running of the shop. Tony is employed by the business as a salesman; he is paid a basic salary of £12,000 per year. Tony is also paid commission: he receives 2.5 per cent of the value of anything he sells. This means that Tony will get paid £12,000 a year (£1,000 per month) even if he sells nothing.

If Tony sells carpets to the value of £8,000 and beds to the value of £2,000 in one month, he will receive £1,250 for that month. How is this calculated? £8,000 added to £2,000 is £10,000; 2.5 per cent of £10,000 is £250; add this to the basic salary of £1,000 gives £1,250. This means the more Tony sells, the more money he earns.

Table 54.1 The advantages and disadvantages of awarding a bonus

Advantages of bonuses	Disadvantages of bonuses
An unpromised bonus might be a great reward for a worker who's achieved great things during the year	A bonus-driven business pushes staff to lower their ethical standards in pursuit of the money (the bankers' bonus problem)
If a company has made huge profits, staff would be thrilled to receive a payout	Firms can end up giving bonuses for staff completing ordinary tasks – such as footballers being paid 'appearance money'
Bonuses may be a help in getting staff to do the less pleasant part of their jobs, e.g. a bonus for getting dull paperwork tasks done on time	Once staff get used to bonuses, they can come to expect them rather than be thrilled by them; John Lewis staff may have enjoyed their 10 per cent bonus in 2016, but how did they feel in 2020 when the bonus was 0 per cent?

Some sales people are paid on a commission-only basis. This is harsh to the point of cruelty. A bad week means zero income – and in industries such as double-glazing, a bad week is always a possibility.

Talking point

If working on a till paid £9 an hour and cleaning the toilets paid £14 an hour, which would you choose? Why?

Promotion

In the long term an employee's earnings are mainly going to be affected by promotion. Some will enjoy a steady rise up the career ladder, ending up with a big salary and a fat pension. Some may even deserve this. Unfortunately, many big businesses in the UK are famously badly run – and the heart of the problem is middle senior management. Both Morrisons and Tesco seemed to do significantly better after making substantial cutbacks to their senior management ranks.

The problem is that promotions often happen for the wrong reason. Employee A, who argues a lot (showing that they care), is cast aside for 'Mr Yes', who nods at the right time. In this way junior staff learn that promotions don't happen to the best staff, or even the brightest, but the 'yes-iest'. Of course, well-run businesses – such as Jaguar Land Rover, Dyson and Apple – are quite different, but they may be in the minority.

> Motivation is a fire from within. If someone else tries to light that fire under you, chances are it'll burn very briefly.
>
> *Stephen Covey, business writer*

Non-financial methods to motivate employees

Job rotation

Job rotation means that an employee does several tasks within the working day. It is intended to stop the boredom of doing one thing constantly. So, instead of sitting at the checkout all day, you might spend two hours refilling shelves and an hour on customer services. As motivation comes from within, this can only work if carrying out more tasks leads to a more stimulating working life. There is little evidence that this happens. For the most part, job rotation may help to relieve boredom, but it does little to motivate.

Job enrichment

Job enrichment is defined by Professor Herzberg as 'giving people the opportunity to use their ability'. It means giving more responsibility as well as more tasks. For job enrichment, perhaps the checkout worker should also spend time as a supervisor; for example, from a seven-hour day they might spend two hours as the supervisor of all the checkout staff.

Table 54.2 Looking further at promotions

Promotion: the way it should be	Promotion: the way it often is	Promotion: making it better
Promotions go to the best, the brightest or those showing leadership potential	Promotions go to those whose face fits – and agree with management policies	Managers should learn that different viewpoints can lead to better decisions
Juniors showing leadership potential should get equal training for equal opportunity	Ethnic minority staff don't get put on the training courses that fit with a promotion push	Companies should check whether training opportunities are provided equally
Staff should all aspire to get promoted and therefore have the incentive to be their best	Seeing how things are, many staff don't look for promotion – they look to get out	If not many are applying for promotion, senior managers should investigate why

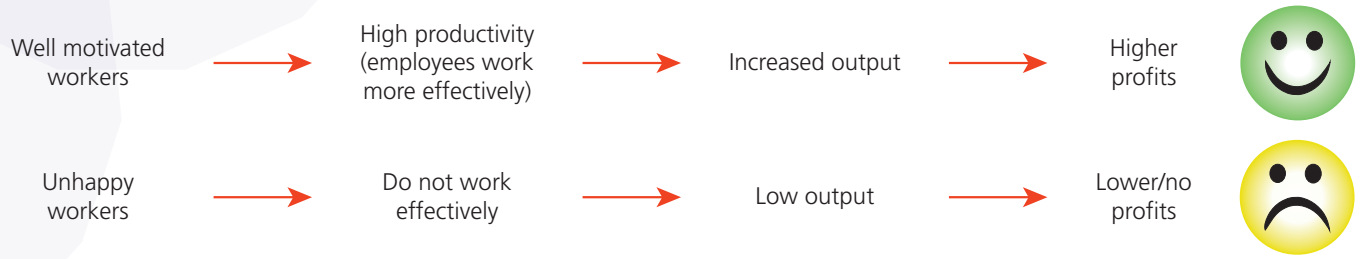


Figure 54.1 Motivation is vital to business success

That would represent a greater challenge, and also give the individual the opportunity to show their abilities to more senior staff. Herzberg suggested the following factors are needed for a job to be considered 'enriched':

- complete unit of work
- self-checking
- direct feedback.

Autonomy

Autonomy means independence, that is, power over your own life at work. Very few people have this absolutely; more have a degree of it. Teachers love a moan but speak most positively about their relatively independent life in the classroom. They decide what they're going to teach that day, and how they're going to do it. By contrast, a train driver has huge responsibility but little or no autonomy. Autonomy is potentially a huge contributor to motivation.

Drawing the right conclusions

The most successful companies are usually those with the best-motivated staff. People who have started their own business can underestimate the importance of this. They often expect people to find the motivation from within, without doing enough to create a situation in which staff can easily be motivated. If the boss barks out orders and hands over a series of dull tasks, it is no surprise if staff dislike their work. Motivation requires a manager to think about how best to organise work so that staff feel that their intelligence is being used properly. This is where job enrichment and even autonomy should be considered.

Revision essentials

Autonomy: the independent power to decide on what you are going to do at work.

Commission: being paid a percentage of the value of a sale you have made, for example a ten per cent commission.

Fringe benefits: rewards you get from work other than pay, such as a company phone or car.

Job enrichment: being given a range of activities and responsibilities that enable the worker to learn and to grow.

Job rotation: having several tasks to do at work to relieve the boredom of doing the same thing all the time.

Remuneration: all the financial rewards received from work, whether direct, such as a salary, or indirect, such as free membership of a sports club.

End of chapter exercises

1 What is it called when employees are given perks in addition to their pay?

2 Identify three benefits that a highly motivated employee might bring to a business.

3 How might the store manager at a Costa Coffee boost staff motivation?

4 Should your teacher's salary be stopped and instead be paid solely on the basis of the coming year's GCSE results?

5 Which matters more in achieving an Olympic medal in cycling: ability or motivation? Explain your reasoning.

6 Read the following extract and answer questions (a) and (b).

Aston & Magill cafe employs two staff who are paid out of the quite satisfactory weekly takings. But now a Costa is to open 50 metres away – the first chain to open up nearby. Boss Cara Aston is worried about the new competitor and thinks that her staff need to be more motivated in order to give better customer service.

(a) Explain how staff motivation might affect customer service.

(b) Discuss whether the business would be better off using financial or non-financial methods to try to achieve the improved motivation.

Practice questions

Former prisoners help Timpson

James Timpson, CEO of the family-owned key-cutting and shoe-repair business Timpson, was a guest at Judge Business School, Cambridge. James talked to host Pamela Mungroo. Here are some edited highlights:

Q: What is the culture of Timpson?

We employ colleagues who have a great personality and we train them to have the skills that they need to serve our customers well. It's a culture based on trust and kindness. It's not based on trying to make money, but I believe that if you do things well and have motivated, happy colleagues you end up making money at the end of the year.

Q: Why are your thousands of employees called 'colleagues'?

The word 'staff' implies to us that someone is less important than someone else, but they're not. Everybody in the business is empowered to do their job without asking permission. Just follow our two golden rules: you put the money in the till and you look the part – which means you open up on time, make the shop look smart, and are kind to people.

Q: Why do you recruit ex-offenders who have served prison time?

The reason why we recruit people from prison is because I've learned that it's a really good way of finding amazing people, but it started by chance: my mother was a foster carer for many years and I was brought up with foster children, and a lot came to us because their mums were in prison. We've now got to the stage where 10 per cent of my colleagues are people with prison experience. They are treated like everyone else: if they work really hard and do the right things they get promoted, and off we go.

Q: How do you measure success of the business?

We don't have profit targets, we make what we make. We try to buy things at the lowest prices possible and get the lowest rents – that's being commercially successful. But the way I measure our success is by going around our shops, and what I'm looking for is how amazing our colleagues are, how amazing the standards of our shops are, and what the buzz is like.

I like meeting my colleagues and I like knowing they are really happy and fulfilled and they really like working for the business. That is my motivation.

Source: Adapted from www.jbs.cam.ac.uk/insight/2020/key-business-ideas

Total: 20 marks

1 Outline how motivation at Timpson may affect the productivity of its staff. (2)

2 Analyse the benefits Timpson may receive from its approach to former prison inmates. (6)

3 Evaluate whether Timpson focuses on financial or non-financial methods of motivation. You should use the information provided as well as your knowledge of business. (12)

Exam-style questions on Topic 2.5

Don't rush; check your answers carefully.

1 Which **one** of the following is the best explanation for a rise in the productivity of a UK car manufacturer? [1]

(a) Recruiting more staff.

(b) A rise in UK economic growth.

(c) Higher investment in new technology.

(d) More support staff to help operational staff.

2 Which **two** of the following are benefits to a business from decentralising? [2]

(a) Helps maintain the consistency of customer experience.

(b) Encourages junior staff to take more initiative.

(c) Makes sure you get the best from high-paid senior staff.

(d) Cuts down on management costs.

(e) Makes sure decisions are taken closer to the customer.

3 Which **one** of the following is most likely to improve motivation in a factory? [1]

(a) Enriching the job by providing a wider variety of tasks

(b) Tighter supervision, to make sure staff are working hard

(c) Cutting back on fringe benefits

(d) Reducing the autonomy staff face day to day

4 Which **one** of the following is the best explanation of the term `retention'? [1]

(a) Getting staff to work harder so they earn higher bonuses

(b) It measures how many staff leave per year out of all the staff employed

(c) It means warning staff to work harder if they want to keep their job

(d) It measures how many staff stay with the firm as a percentage of all those employed.

5 A person specification would have to include which **one** of the following? [1]

(a) The main duties and tasks involved in the job

(b) The skills or experience needed for the role

(c) References from previous employers

(d) Details of the number of staff the person recruiting would be in charge of

6 Which **two** of the following are significant barriers to communication? [2]

(a) In a flat hierarchy there may be too many layers of management.

(b) Shop-floor workers rarely socialise with management.

(c) Lack of motivation on the part of the worker/listener: 'who cares?'

(d) A hierarchical structure may make communication too slow from bottom to top.

(e) The company has too high a level of labour retention.

7 Which **one** of the following is a reason why a worker may prefer permanent to temporary work? [1]

(a) Permanent jobs are more likely to be supported by investment in new technology.

(b) Temporary work may fit better with an individual's lifestyle.

(c) Permanent work ensures that the employee benefits from remuneration.

(d) Greater job security lowers the pressure adults can feel about family finances.

8 Which **two** of the following would impress an employer looking at a school-leaver's CV? (2)

(a) Hearing about hobbies such as scrolling TikTok or defeating aliens on PS5.

(b) Evidence of leadership skills such as being captain of a school team.

(c) Hearing that they enjoy sports – but only watching, not playing.

(d) Evidence that they started and ran a market stall for six months until GCSE exams loomed.

(e) Evidence that they work hard at their favourite subjects.

Now try this discussion question.

9 Discuss whether a new business could benefit from keeping a flat hierarchy as it grows. (6)

Glossary

Adapting existing products Finding new products that are based on the original one, such as Walls' White Chocolate Magnum.

Aesthetics How things appeal to the senses: Do they look great, smell good, feel nice, sound solid (the 'ker-lunk' of a BMW door shutting) and taste great?

Aims A general statement of where you're heading; for example, 'to get to university'.

Application form The series of questions a job-seeker must fill in when trying to get an employer interested in interviewing them.

Automation Using machines that can operate without people.

Autonomy The independent power to decide on what you are going to do at work.

Availability Knowing how to get the right supplies quickly – just when you need them.

Average rate of return (ARR) Average yearly profit as a percentage of the sum invested. This shows profitability and can be compared to the interest rates available on bank deposit accounts.

Bankrupt When an individual is unable to pay his/her debts, even after all personal assets have been sold for cash.

Bar chart Data presented so that the height of the bar represents the quantity involved; good for making comparisons.

Bar gate stock graph A diagram to show changes in the level of stock over time.

Barrier to communication Something that prevents the flow of communication.

Batch production Producing a limited number of identical products.

Branding Giving your product or service a name that helps recall and recognition, and gives a sense of personality.

Break-even The level of sales at which total costs equals total revenue. At this point the business is making neither a profit nor a loss.

Break-even output = fixed costs / (price – variable costs per unit)

Break-even chart A graph showing a company's revenue and total costs at all possible levels of output.

Budget A ceiling on the amount of money that can be spent. A marketing budget of £1 million means the marketing manager can spend up to that figure, but no more.

Buffer stock A minimum stock level to be held at all times, to avoid the risks involved if a supplier fails to deliver on time.

Business decisions Choices that have to be made, usually within a short time period.

Business failure The collapse of a business, probably leading to its closure.

Business growth Factors allowing a company to expand through higher sales and (usually) higher staff levels.

Business operations The section of an organisation concerned with making and delivering what the customer wants.

Business performance Ways of measuring how well a business has done in the recent past (often the basis for setting targets in the future).

Business plan A detailed document setting out a new company's aims, plans and cash flow forecasts.

Cash The money the firm holds in notes and coins and in its bank accounts.

Cash flow The movement of money into and out of the firm's bank account.

Cash flow forecast Estimating the likely flows of cash over the coming months and therefore the overall state of one's bank balance.

Centralised organisation An organisation in which most decisions are made at head office.

Choice Giving customers options and increasing the chance that a product will be available which is perfect for the tastes/habits of one type of customer.

Closing balance The amount of cash left in the bank at the end of the month.

Commission Being paid a percentage of the value of a sale you have made, for example, a '10% commission'.

Communication The passing of information from one person or organisation to another.

Competing internationally Finding a way to succeed against rivals from overseas.

Competition Companies operating in your market or market sector.

Competitive advantage Features of a product or service that make it stronger in the marketplace than its competitors.

Competitive environment The strength of competition between companies operating in a market.

Consumer incomes The amount available to be spent by households after income taxes have been deducted.

Consumer law Acts of Parliament that are intended to protect customers from misleading or dangerous practices by companies.

Consumer rights Laws that empower the consumer to demand certain minimum standards from every business supplier.

Consumer spending The total spent by all shoppers throughout the country.

Convenience Making life easier for customers, perhaps by a great location (next to the bus stop) or a product that saves time in preparation or consumption.

Crowdfunding Raising capital online from many small investors (but not through the stock market).

Culture 'The way we do things round here'; in other words, the accepted attitudes and practices of staff at a workplace.

Curriculum vitae (CV) A document which sets out the person's qualifications, experience and any other relevant facts (it literally means the 'story of life').

Customer engagement The attempt to make a customer feel part of something rather than an outsider.

Customer feedback Comments, praise or criticisms given to the company by its customers.

Customer needs The products or services people need to make life comfortable.

Customer wants What people choose to spend their money on, once the weekly bills have been paid.

Decentralised organisation An organisation which allows staff to make decisions at a local level.

Demand The number of units that customers want – and can afford – to buy.

Demographics The study of the statistical differences that exist within a population, both now and in the future.

Design Deciding how something will look, both internally (the gearbox) and externally (the bonnet).

Design mix Finding the right design balance between function, aesthetics and cost of manufacture.

Digital communication Messages or conversations conducted via email, text or social media.

Distribution How ownership changes as a product goes from producer to consumer.

Dividends Payments to shareholders from the company's yearly profits. The directors of the company decide how large a dividend payment to make; in a bad year they can decide on zero.

Dynamic nature of business The idea that business is ever-changing because external factors, such as technology, are always changing.

E-commerce Selling online rather than in a physical one-to-one transaction. An important part of e-commerce is m-commerce, meaning commerce using apps/phones rather than websites/PCs.

Economic climate Like the weather, the economy can run hot or cold; the economic climate is a measurement of the current economic outlook, which might be promising or worrying.

Economic manufacture Making the product cheaply enough to make it profitable.

E-newsletters Regular updates on the activities of a business, sent electronically to actual or potential customers.

Entering markets When a company decides to open up in a market it hasn't been in before, for example, Walkers making cereal bars.

Enterprise The personal characteristics of questioning and initiative that can be shown by an employee or an entrepreneur.

Entrepreneurs Businesspeople who see opportunities and are willing to take risks in making them happen.

Environment The condition of the natural world that surrounds us, which is damaged when there is pollution.

Environmental considerations Factors relating to 'green' issues, such as sustainability and pollution.

E-tailer An electronic retailer; in other words, purchasing electronically, either by e-commerce or, more likely these days, mobile commerce ('m-commerce').

Ethical considerations Thinking about ethics, which may lead to morally valid decisions, or may lead to the manipulation of customer attitudes, that is, pretending to be ethical.

Ethics Weighing up decisions or actions on the basis of morality, not personal gain.

Excessive communication Too much communication causing overload for staff – a particular problem with email.

Exchange rate The value of one currency measured by how much it will buy of other currencies.

Exiting markets Choosing to leave a market, probably because it was loss-making.

Exports Goods produced in one country but sold to buyers overseas, for example, a British-made Mini sold in France.

Extension strategy An attempt to prolong sales of a product for the medium to long term to prevent it from entering its decline stage.

External influences Factors and changes from outside that might prevent a business achieving its objectives, for example, sales being hit by a sudden recession.

External recruitment Appointing from outside the existing staff.

Fairtrade A social movement whose goal is to help producers in developing countries achieve better trading conditions and to promote sustainability. It ensures that the price paid is high enough to allow fair wages to be paid to the workers who produced the goods. Fair trade certification can be found on many products, including KitKat.

Fixed costs Costs that don't vary just because output varies, for example, rent.

Fixed premises Buildings that have to be where they are, for example, the high street; e-commerce buildings can be located anywhere.

Flat structure An organisation with few layers of hierarchy – presumably because each manager is responsible for many staff.

Flexibility The ability to switch quickly and easily from one task to another.

Flexible hours A contract between a company and an employee that doesn't specify how many hours of work will be provided.

Flotation Listing company shares on the stock market, allowing anyone to buy the shares. This means the price can float freely (up and down).

Flow production Continuous production of identical products, which gives scope for high levels of automation.

Focus group A group discussion among people selected from the target market. It draws upon psychology to provide qualitative insights into consumer attitudes.

Formal training The official training programme put on by the company, for example a two-year graduate training programme

Formula A way of showing how the components of a calculation can be turned into an answer, for example, 'revenue – total costs = profit'.

Franchising Paying a franchise owner for the right to use an established business name, branding and business methods.

Free trade Trade between countries with no barriers, for example, no tariffs.

Freelance contract An agreement over one job between a company and a self-employed worker.

Fringe benefits Rewards you get from work other than pay, such as a company phone or car.

Function How well the product or service works for the customer, for example, are the beds comfortable at a hotel? Does the smartphone take sharp photos?

Gap in the market An area on a market map where few or no existing brands operate, implying a business opportunity to fill an unmet consumer need.

Globalisation The increasing tendency for countries to trade with each other and to buy global goods such as Coca-Cola, or services such as Costa coffee.

Goods Products that may be grown such as apples or manufactured such as Heinz Baked Beans.

Graph Data presented as lines, making it easy to identify trends, especially if 'time' is shown on the horizontal axis.

Gross profit margin Gross profit as a percentage of sales revenue or, for an individual item, gross profit as a percentage of the selling price.

Hierarchical structure An organisation with many layers of management, therefore creating a tall organisational pyramid.

Human resources A term used by organisations that simply means employees.

Identifying customers Finding out who they are: their age, gender, incomes, where they live and what they want.

Imports Goods or services bought from overseas.

Independence The need of many business owners to make their own decisions; be their own boss.

Inflation The rate of increase in the average prices of goods and services.

'Inform' decisions Evidence that can be used to make a better decision. Through the 4Ps, a company can gain a better understanding of its customers that helps in decision-making.

Informal training Learning on the job, usually through advice and tips from colleagues.

Innovation Bringing a new idea to the market, such as Warburton's clever idea of an extra-large crumpet.

Innovative A new, perhaps original, product or process.

Inorganic (external) growth Growing by buying up other businesses or by merging with a business of roughly equal size.

Insolvency When a business lacks the cash to pay its debts.

Insufficient communication Too little communication, which might leave some staff under-informed and demotivated.

Interest The regular charges made by banks for the cash they have lent to a business, for example, 'six per cent per year'.

Interest rate The annual cost of a loan to the borrower.

Internal recruitment Appointing from within the existing staff.

Job description A short account of the main features of the job.

Job enrichment Being given a range of activities and responsibilities that enable the worker to learn and to grow.

Job production Production of a one-off item for a single customer.

Job rotation Having several tasks to do at work to relieve the boredom of doing the same thing all the time.

Just In Time (JIT) Running the business with so little stock that new supplies have to arrive 'just in time' before they run out.

Lack of financial security Uncertainty for the business owner about day-to-day family income and assets.

Legislation Laws passed by Acts of Parliament; breaking those laws may result in a fine or even a prison sentence.

Lifestyle Grouping people by common characteristics based on how they live, from sports and leisure to views regarding the environment, interest in music festivals or nerdier things such as a passion for trains.

Line graph Data presented as lines, making it easy to identify trends, especially if 'time' is on the horizontal axis

Limited liability Restricting the losses suffered by owners/shareholders to the sum they invested in the business.

Location The extent to which consumers identify with the place where they were born, or grew up.

Logistics ensuring that the right supplies will be ordered and delivered on time.

Managing quality Choosing the right method for achieving high-quality results, then supervising what workers actually do, day by day.

Manufacturing Turning raw materials into finished products ready for sale; usually takes place in a factory.

Margin of safety The amount by which demand can fall before the business starts making losses.

Margin of safety = sales – break-even output

Marketing mix The blend between product, price, promotion and place that can help a business achieve its revenue targets.

Market map Measuring where existing brands sit on a two-factor grid, for example, young/old compared with high price/low price.

Market segments The subsets within a market that have been identified as a result of market segmentation.

Market share The percentage of a market held by one company or brand.

Mentor Someone in the workplace who gives you advice and help, officially or unofficially.

Merger When two businesses of roughly equal size agree to come together to form one big business.

Negative cash flow When cash outflows are greater than cash inflows.

Net cash flow Cash in minus cash out, over the course of a month.

Net profit margin Net profit as a percentage of sales revenue or, for an individual item, net profit as a percentage of the selling price.

Objectives A clear goal that is measurable, so success or failure is clear to see.

Obsolete A product or service with sales that have declined or come to an end as customers find something new.

Ongoing training Regular, perhaps weekly, training sessions for all staff.

Opening balance The amount of cash in the bank at the start of the month.

Operational decisions Deciding on key production factors, such as how to manage quality or how much stock to order.

Organic (internal) growth Growth from within the business, such as creating and launching successful new products.

Organisation chart A diagram that shows the internal structure of an organisation.

Original ideas Ideas that have not been done before.

Overdraft The amount the business uses of the facility provided by the bank for short-term borrowing.

Overdraft facility An agreed maximum level of overdraft.

Payment systems Ways of paying electronically, such as PayPal.

Performance reviews Discussion sessions between the employee and their boss (perhaps every six months) about how well the employee is doing against the targets set for them.

Permanent contract An agreement between a company and an employee that work and income will be provided constantly into the long-term future.

Person specification An account of the type of person who would best fit the job: their character, experience and skills.

Pie chart Data presented in a circle, with each slice of the pie representing a proportion of the whole; good for representing proportions of a total, for example, market share.

Place How and where the supplier is going to get the product or service to the consumer; it includes selling products into retailers and getting the products displayed in prominent positions.

Post-sales service Service after the purchase is completed, perhaps because something has gone wrong or as a way of promoting customer engagement.

Pressure group An organisation formed to put forward a particular viewpoint, such as promoting organic farming.

Price Setting the price that retailers must pay, which in turn affects the consumer price.

Primary research Research conducted first hand; it is tailored to a company's specific needs, for example, a quantitative sales estimate for a brand new chocolate bar.

Private limited company A small family business in which shareholders enjoy limited liability.

Procurement Obtaining the right supplies from the right supplier.

Product Targeting customers with a product that has the right blend of functional and aesthetic benefits, without being too expensive to produce.

Productivity A measure of efficiency, usually output per person per time period (for example, Nissan UK's 98 cars per worker per year).

Product knowledge How well staff know all the features of the products and the service issues surrounding the products, such as the precise terms of Kia's seven-year warranty on its new cars.

Product life cycle The theory that every product goes through the same four stages, of introduction, growth, maturity and decline.

Product range The number of different product types, sizes, colours and brands offered by a company.

Product differentiation The extent to which consumers see your product as being distinct from its rivals.

Profit The difference between revenue and total costs. If the figure is negative the business is making a loss.

Profit margins Profit as a percentage of the selling price (for one unit) or as a percentage of total sales revenue (for the business as a whole).

Promotion Within the 4Ps, promotion refers to all the methods a business uses to persuade customers to buy, for example, branding, packaging, advertising to boost the long-term image of the product and short-term offers.

Promotional strategy A medium- to long-term plan for communicating with your target customers.

Proximity Nearness; whether or not a business wants to be close to a factor such as 'materials'.

Public limited company (plc) A company with at least £50,000 of share capital that can advertise its shares to outsiders and is therefore allowed to float its shares on the stock market.

Qualitative data In-depth research into the opinions of a small group of potential or actual customers – to provide insight into why consumers buy what they buy.

Quality To a customer, quality means getting what they want – or perhaps better than expected; some companies use the term 'customer delight'.

Quality control Putting measures in place to check that the customer receives an acceptable level of quality.

Quantitative data Factual research among a large enough sample of people to provide statistically reliable results, for example, a survey of 500 15–24-year-olds.

Recession A downturn in sales and output throughout the economy, often leading to rising unemployment.

Red tape The term given to laws that (some people say) tie the hands of businesspeople, making it hard to act entrepreneurially.

References People such as teachers and previous bosses who are willing to answer questions about the qualities of a job applicant.

Remote working Working away from the office, typically from home.

Remuneration All the financial rewards received from work, whether direct, such as a salary, or indirect, such as free membership of a sports club.

Research and development (R&D) The scientific research and technical development needed to come up with successful new products.

Resources Things or people that can be used to help build and run the business.

Retailer A shop or chain of shops, usually selling from a building in a high street or shopping centre.

Retained profit Profit kept within the business (not paid out in dividends); this is the best source of finance for expansion.

Retention A calculation of how many staff stay loyal rather than leaving, for example, staff staying as a percentage of all staff.

Risk and reward The balance between the worst that can happen and the best that can happen.

Risk-taking Making decisions where unknown factors or chances of failure loom large in the decision-maker's mind.

Robots Machines that can be programmed to do tasks that can be done by humans, such as welding, spray painting and packing.

Role of business enterprise What business organisations are for, such as to meet consumer needs and wants.

Royalties A percentage of the sales revenue to be paid to the overall franchise owner.

Sales process All the factors required to ensure that an interested customer becomes a buyer.

Sales revenue The total value of the sales made within a period of time, such as a month.

Secondary research When a company uses research that has already been carried out for general purposes.

Self-learning Teaching yourself, perhaps by thinking why a problem occurred – and making sure you learn from your mistakes.

Services Providing useful ways to help people live their lives, for example shops, restaurants and hospitals.

Share capital Raising finance by selling part-ownership in the business. Shareholders have the right to question the directors and to receive part of the yearly profits.

Shareholders Those who have bought shares in the business, giving them part-ownership and therefore, potentially, partcontrol.

SMART objectives Targets that are specific, measurable, achievable, realistic and time-bound.

Social media Interactive channels of communication, via words, photos or videos, such as blogs, Facebook and Instagram.

Social objectives The possible goals of a business based on its contribution to society.

Sole trader A business run by one person; that person has unlimited liability for any business debts.

Sources of business finance Places where finance might be found, for example, banks or individuals.

Sponsorship When companies pay to have a brand associated with an iconic individual or event (usually connected with sports or the arts).

Stakeholders All those groups with an interest in the success or failure of a business.

Stock(s) Items held by a firm for use or sale, for example, components for manufacturing, or sellable products for a retailer.

Sum invested The cash put at risk when investing in new equipment or a new product.

Survival Keeping the business going – which ultimately depends on determination and cash.

Sustainability Whether or not a resource will inevitably run out in the future. A sustainable resource will not.

Takeover Obtaining control of another business by buying more than 50 per cent of its share capital.

Target-setting When you are set goals by a manager, and your job is to achieve them.

Tariffs Taxes charged only on imports.

Taxation Charges placed by government on goods, imported goods and the incomes of individuals and companies.

Technology Hardware and software that can help people be more productive.

Temporary contract An agreement between a company and an employee that work and income will be provided for a specific time period, say, six months.

Total costs All the costs for a set period of time, such as a month.

Trade bloc A group of countries that has agreed to have free trade within external tariff walls.

Trade credit When a supplier provides goods but is willing to wait to be paid, for perhaps up to three months. This helps with cash flow.

Trade-offs How having more of one thing may force you to have less of another, for example, higher ethical standards may mean less profit.

Trust Building a business relationship in which both sides know that the other won't let them down.

Understanding customers Learning why customers do what they do – making it easier to understand how to make a product that better suits them.

Unemployment When someone of working age wants a job but cannot get one.

Unethical An action or decision that is wrong from a moral standpoint.

Unique Selling Point (USP) An original feature of a product that rivals aren't offering.

Unlimited liability Treating the business and the individual owner as inseparable, therefore making the individual responsible for all the debts of a failed business.

Value added The difference between the selling price and the cost of bought-in goods and services (the difference that creates the possibility of profit).

Variable costs Costs that vary as output varies, such as raw materials.

Venture capital Capital provided by an investor willing to take a risk in return for a share in any later profits; the venture capital provider will take a share stake in the business.

Viral advertising When people start to spread your message for you, through social means, be it word of mouth or via social media.

Working with suppliers Building a business relationship so that your suppliers can be trusted to deliver high quality materials on time.

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